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# THE TARIFF ACT OF 1913

SUMMARY

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THE Tariff Act of 1913 is described both by friends and enemies as a radical measure. It is said not only to lower duties, but to introduce new methods of assessing them and to rest upon principles essentially different. How far can it be said to make sweeping changes?

The new principle of which most has been made by the advocates of the act is that of a "competitive tariff." In 1909, the Republicans had professed to act on quite a different principle, — that of equalizing cost of production. These two have been set forth by both sides as starting from opposite poles in the

tariff controversy. And yet, impartially considered, and assuming consistent application, they would seem to come to very much the same thing. The notion underlying equalization of cost of production is that of enabling the domestic producer to compete on even terms with the foreign producer. This would seem to be essentially the notion of a "competitive tariff." It is true that in the statements of the principle of equalization, something was always said of a "reasonable profit" to the domestic producer; whereas the Democrats, when explaining what was meant by a "competitive tariff," poohpoohed reasonable profits, and intimated that the competition should be such as to cut down domestic profits, and perhaps wipe out some of them. Yet a reasonable profit is obviously to be considered among the normal expenses of production, even tho it be not so reckoned under the usual methods of cost accounting. A "competitive tariff" would seem to be one under which domestic and foreign producers could compete in such manner that both should get reasonable profits. Fairly and consistently applied, therefore, the principle of a competitive tariff cannot be said to differ in essentials from that of a tariff equalizing cost of production.

In discussing the Tariff Act of 1909, I took occasion to point out the obvious fact that universal equalization of cost of production means universal application of protection.[1] However high cost of production may be in the United States, duties must be made high enough, on this principle, to offset the difference. Anything and everything is to be made at home. The principle of a "competitive tariff" perhaps does not go quite so far, especially if applied with a less generous

[1] In this Journal for November, 1909; cf. also my Tariff History of the United States, ed. of 1910, p. 363.

reckoning of the domestic producer's expenses. None the less, under that principle also duties should be made high on commodities produced in the United States under disadvantagous conditions and therefore at heavy expense. The notion of the " competitive tariff " is no less inconsistent with the principle of free trade than is the rival one. Under consistent free trade, the competition between the foreign producer and the domestic producer would not be a weighted one, with handicaps in favor of the domestic producer; it would be quite an even one. The principle of a " competitive tariff " would seem to mean merely that protection should not be unnecessarily high, yet high enough to ensure the maintenance of domestic production.

Another phrase much used in the debates of the current session was that of a " legitimate " industry. No legitimate industry, it was said, would be endangered. What is an illegitimate industry ? One that cannot maintain itself without some sort of legislative prop ? or one that has lost the right to a prop because of the methods by which its promoters have sought to influence legislation in the past ? or one that has secured unusual profits through monopoly or semi-monopoly ? Perhaps legitimate industries are those which, under protection, have been securing no more than normal or reasonable profits. Perhaps the phrase refers to industries which could hold their own under a comparatively moderate scale of duties, but rules out industries depending upon a range of duties distinctly high. Or it may mean that vested industries should not be disturbed, — industries established on the supposition that the policy of protection, maintained for so many years, would be continued indefinitely. Hardly any intimation was given that an industry was illegiti-

mate merely because dependent on protection. Neither phrase, — "legitimate" industries nor "competitive" industries, — was used in such a way as to commit its advocates to the abolition of protection or to a consistent application of free trade.

All such catchwords, however, are less important in their strict and consistent meaning than in what they imply to the average voter. Their implications are by no means the same. They suggest very different points of view. The Republicans, when they professed to be desirous of merely equalizing costs of production, made it clear that they meant duties to be kept amply high enough to leave the domestic producer in command of the situation. The Democrats, when they spoke of competition, meant that duties should be kept below the point of prohibition. The Republicans wished to make sure of keeping imports out; the Democrats wished to make sure of letting some in. And further, the Democrats, however, they might speak of competitive rates and "legitimate" industries, reserved the alternative, where political or economic expediency prompted it, of throwing these principles to the winds and of fixing duties quite without regard to competition or legitimacy.

None the less, there was occasional discussion that implied the orthodox free trade reasoning. "Legitimate" industries were sometimes described as those economically legitimate; that is, such as could hold their own without protection. It would follow that every industry dependent on protection was illegitimate. From still another point of view the illegitimacy of protection as such was implied. Mr. Underwood presented, in a widely circulated speech,[1] some esti-

[1] The speech was made in the House, April 23, 1913, and widely circulated in pamphlet form.

mates of the taxes which the consumer paid under the tariff, and reckoned among these the amounts paid in the form of higher prices on commodities produced at home. Calculations of this kind call for the greatest caution. There are but few commodities, — sugar and wool might be instanced, — for which it can be figured out with any accuracy how great is the rise in price which the duties cause, and how great is the total burden on the consumer if both domestic output and imports be considered. In most cases figures of this sort rest on guess work. Such, for example, is the case with calculations of the total burden from the duties on cottons, silks, woolens, glass ware, manufactures of iron. This much, however, is to be said: one who parades such figures uses the essential argument for free trade. He can hardly admit the stock protectionist pleas, under which it is not admitted for a moment that there is a real tax on the consumer, still less a net loss to him, because of higher prices of commodities produced within the country. One who argues after this fashion would seem not to be able to use the principle of a "competitive tariff," which assumes a partition of the market between the domestic producer and the foreign; or at the most he can use it only as a sort of stopgap, a rough and ready expedient for keeping duties within the bounds set by regard for vested interests.

Perhaps no topic brought into clearer light the mode in which the two parties approached the tariff question than that of the expediency of maintaining a tariff board. Unless the principle of free trade is to be fully and consistently applied, there is ground for detailed inquiry on the facts of each particular industry. Under free trade, such inquiry is superfluous. All that needs then to be done is to treat the imported and domestic

supply on the same terms: either tax both at the same rate, or free both from taxes, and let the results of completely equal competition work themselves out. But this drastic treatment no one proposes, at least for immediate general application. Now if the basis of adjustment is to be that of making conditions competitive, or that of equalizing cost, or that of regarding most established industries as legitimate, — on any such basis the question in each particular case must arise what precise rate of duty brings about the desired adjustment. Hence the Republicans had much to say about the need of an expert board of investigators and the recklessness of disturbing the foundations of industry without painstaking examination. That the Ways and Means Committee of the House, or the Finance Committee of the Senate, was not in position to make such investigation was now freely admitted by the Republicans. They did not deny their own sins of the past in this regard, but urged improvement for the present and the future. There was much complaint that the Democratic Ways and Means Committee had proceeded roughshod, arrived at duties by guess work, and fixed rates on materials and half finished commodities that were inconsistent with rates upon finished or nearly finished commodities. The new tariff, it was said, was not a "scientific" tariff.

In this there was not a little truth. The duties were, in fact, settled in more or less rough and ready fashion. Doubtless the exact rates in many cases were the results of compromise, not of any close calculation or accurate information. Beyond question the same sort of thing had gone on in previous years, and even more flagrantly. But the Republicans could maintain that since 1909 the Tariff Board had

been at work, and had shown the possibility of more deliberate and discriminating procedure. And yet the Democrats could not be seriously expected to pay much attention to this demand for prolonged preparation and expert examination. In the first place, the Tariff Board was a Republican device. However excellent its work, — and no competent observer will deny that it has thrown much needed light on all the topics which it has investigated, — a flavor of partisanship remained. The very fact of its being a Republican product caused the Democrats to turn their backs on it. More important, however, was the circumstance that detailed and elaborate inquiry necessarily meant delay. The Democrats were not to be blamed for believing that, however unbiased the members of the Tariff Board may have been, and however excellent their work, the real object of the Republican leaders who championed the Board was to stave off early action and perhaps give a chance for the political situation once more to take a turn in their favor. Postponement of action by the Democrats until the results of an expert board's inquiries should be at hand was to give up their golden opportunity. They had control for the first time in many years of all branches of the national legislature, — not only the House and the Presidency, but even the Senate. Their time had come, and to have waited would have been politically suicidal.[1]

[1] Something which may possibly be equivalent to the work of the Tariff Board has been provided in one of the closing paragraphs of the Act (Section IV, Paragraph S) under which "The President shall cause to be ascertained each year, the amount of imports and exports of the articles enumerated in the various paragraphs in section one of this Act and cause an estimate to be made of the amount of the domestic production and consumption of said articles, and where it is ascertained that the imports under any paragraph amount to less than 5 per centum of the domestic consumption of the articles enumerated he shall advise the Congress as to the facts and his conclusions by special message." The notion of a competitive tariff seems to underly the provision. Nothing is said about cost of production, which played so large a part in the instructions to the old Tariff Board, and in its investigations.

Among the changes in duties made in the act of 1913 by far the most conspicuous and important are those on sugar and wool. Both are admitted free; wool at once, and sugar after an interval of three years.

The duty on sugar under the Acts of 1897 and 1909 had been one and two-thirds cents (on the grade most largely imported and commonly taken as the standard). The duty becomes one cent a pound, until May 1, 1916; after that date, all sugar is to be admitted free. The transitional duty of one cent a pound remains subject to the reduction of 20 per cent for sugar from Cuba, whence most of the imports have come in the past, and whence virtually all of them are likely to come in the near future. There are some clear advantages in the course thus taken, and more particularly in the three-year interim.

In the first place, there is a fiscal advantage in postponing complete remission. The sugar duty contributes heavily to the customs revenue. The income tax, which is expected to make up for loss in the customs revenue, will almost certainly require time for working out its full yield. The temporary retention of the sugar duty eases the process of fiscal rearrangement.

Second, the sugar producers are given time for readjustment to new conditions. The production of raw sugar, whether cane or beet, is in these modern days a manufacturing industry almost as much as an extractive one. The abolition of the sugar duty presents squarely the problem of vested interests in an industry where there is large investment of fixed capital. In all such cases there is good ground for postponed reductions. But it is to be admitted also that there is likely to remain a lingering doubt whether such a program of reduction will be carried out to the bitter end, and hence some uncertainty whether the transi-

tion will really be prepared for. This is the strong argument against the plan, sometimes advocated as the best for dealing with duties deemed excessive, of spreading all reductions over a series of years. There is always a question whether the political situation will not shift in the meanwhile. Even during the last year or two, when it has been obvious to every unprejudiced observer that a considerable pruning of the protective system was inevitable, the interested producers have continued to manoeuvre against the inevitable, trying to persuade themselves that the changes could be prevented or postponed. The same unwillingness to face squarely an unwelcome prospect may appear during the three-year period allowed before sugar becomes free. It may be thought that the Democrats will lose their majority in Congress at the elections of 1914; still more, that they will lose everything in 1916. The tactics of the protectionists have suggested in many ways that they hope for an early return of the good old days. In this frame of mind, deliberate accommodation to the new tariff conditions is hardly to be expected; and if the present program really is carried out to the bitter end, the sugar producers may be as ill prepared for it in 1916 as they are now.

The strong tactical and political argument for free sugar is that thereby the cost of living will be reduced. Few economists would subscribe to the statement, often made by the Democrats and embodied in their platform, that the tariff system is the main cause of that general rise in prices which people describe as the high cost of living. But here is one commodity which is universally consumed, is made dearer by the existing duty, and is tolerably certain to become cheaper after the remission of duties. It is true that untoward crop conditions may disguise the effect in

1916. It is conceivable that then the abolition of the duty will not cause sugar to be cheaper, but will simply prevent it from becoming dearer. No intelligent person will think that, so far as the effect of the tariff is concerned, this would be an important difference. But the enormous majority of persons think about these matters with singular lack of intelligence; and some chances are taken as regards the impression made on the mass of the community by the free admission of sugar when the final change is postponed for three years.

It is difficult to see how anything can be said in favor of free sugar on the principle of a competitive tariff, or on that of attacking only the " illegitimate " industries. The imports of sugar have always been large. Certainly so far as raw sugar is concerned, there has been steady competition between the domestic producers, as well as between them and the foreign producers. The production of cane sugar and beet sugar within the United States has been as legitimate as can be the case with any highly protected industry. Possibly the circumstance that the sugar planters of Hawaii and Porto Rico, and in less degree those of Cuba and the Philippines, had been among the beneficiaries from the duty, may have promoted an unrelenting attitude. Yet in the main the abolition of the duty, while tactically justified as a move toward lowering the cost of living, can be defended with consistency only on the ground that a cheap supply from abroad is better than a dear supply at home. This is the gist of the principle of free trade.

More considerable economic effects are likely to follow from free sugar than from any other change in the act. Tho the producers in Louisiana and in the beet sugar states have exaggerated their dependence

on protection, — as is habitually done by domestic producers when making pleas for duties, — it would seem that in fact most of them are not able to meet foreign competition on equal terms. Both cane and beet sugar makers have been prosperous of late years; so much is indicated by the increase in their output. Some among them may be able to hold their own even under free sugar. This is more particularly probable for some beet sugar districts advantageously placed in the West. So in the case of Hawaiian sugar: it is to be expected that the output will diminish, yet not that sugar planting will be given up. Hawaii, and Porto Rico as well, will be hard hit, but hardly compelled to give up completely. Cuba and Java will probably send in much larger imports. One may be distrustful of the predictions concerning the extent of these changes, but considerable they are likely to be.[1]

What has been said of free sugar holds for the complete and immediate abolition of the duty on wool. In their tariff bills of 1911 and 1912, the Democrats had not ventured to go so far. It had been proposed to leave the duty on wool at 20 per cent. Through the influence of President Wilson, the bolder step is taken of admitting it free once for all. It will be remembered that this had been the one radical change made in the ill-starred tariff act of 1894. In taking the same unflinching step at the present time, President Wilson showed the unhesitating courage which has won the respect of

[1] On the general sugar situation, — one of the most interesting phases of our tariff history during the last generation, — I refer the reader to my article in the Atlantic Monthly, March, 1908, on "Sugar: a Lesson on Reciprocity and the Tariff"; and on beet sugar, to one in this Journal, for February, 1912, on "Beet Sugar and the Tariff." On this latter topic, see also Dr. R. G. Blakey's careful monograph, "The United States Beet Sugar Industry and the Tariff," Columbia University Studies, No. 119 (1912); and two articles by Dr. Blakey, on "Beet Sugar and the Tariff," Journal of Political Economy, June, 1913, and "The Proposed Sugar Tariff," Political Science Quarterly, June, 1912.

his opponents no less than of his friends. It happened that the juncture was favorable for the change. A sweeping reduction, perhaps amounting to complete abolition, had been on the cards for so many months that the market had adjusted itself to the prospect, and the price of wool had been for some time on a free wool basis.

Here again none of the current formulas were applicable in justification of so sweeping a change, — neither those of the Democrats nor those of the Republicans. The Republican formula about equalizing cost of production had indeed been shown to be quite impossible of application. The excellent report of the Tariff Board had made it clear that the expense of producing wool under the ordinary farming conditions was impossible of any precise demarcation, and that even for wool produced under ranching conditions cost varied so much in different regions as to make the equalization formula useless. The principle of a competitive tariff was quite as unserviceable. The wool duty had for many years been competitive; that is, the imports had been continuous, and had tended to grow. So far as revenue was concerned, complete abolition unmistakeably meant a fiscal loss. Nor could it be said that wool growing was an illegitimate industry, except from the free trader's point of view. Here again, a clear decision seems to have been made against even the veiled and apologetic arguments for protection. I need not repeat my often stated conviction that the decision was wise. Those arguments for protection which have weight with trained thinkers, — young industries, national independence, and the like, — can have no application in this case. The wool duty cannot be defended except from the most extreme protectionist point of view.

The wish to reduce the cost of living doubtless had its effect in bringing about free wool, as it had in securing the decision for ultimate free sugar. Woolen clothing is dearer in the United States than in other countries. Cheaper wool will lessen the difference, and will bring somewhat cheaper clothing. The change is not likely to be as considerable or as conspicuous as in the case of sugar. On an average suit of men's clothes the decline in price, due to free wool, will be not far from one dollar. This is not far reaching, but it is something; and every little tells. Perhaps the Democrats cannily reckoned that the retail clothing dealers would serve their party's turn by parading and magnifying the effect of free wool; they are not unlikely to put this forth as the occasion of those extraordinary bargains which the confiding public never discovers to be other than extraordinary.

The necessary corollary of free wool is the abolition of the compensating (specific) duties upon woolen goods. They go by the board, as they did in 1894. Only the *ad valorem* duties upon woolen goods are retained; and these are substantially reduced. It will be recalled that the *ad valorem* duties of 1897 and 1909 had been upon most goods 50 and 55 per cent. In 1894, the duty on woolens had been left, on the more important classes of goods, as high as 50 per cent. On almost all of the woolen fabrics concerning which controversy has been waged the rate now goes down to 35 per cent. Yarns are dutiable at 20 per cent, tops at 15 per cent. The rates on carpets range from 20 to 35 per cent. The 35 per cent rate now established is that of the original compensating act of 1867.

Nominally, the reduction in protection on woolens is in the reduced *ad valorem* rate only. In fact, however, the abolition of the specific compensating duties means

a further reduction of protection. As is well-known to every one who has given attention to the complexities of schedule K, these compensating duties had given not a little concealed protection. They had been more than enough to accomplish their nominal object, that of simply offsetting the influence of the wool duty in raising the domestic price of wool. This additional concealed protection had not been in the main the consequence, as was so often charged, of deliberate plotting or manipulation. It had been the result of gradual and in some respects unexpected changes in the development of the industry. Whatever the process by which the result had been brought about, the duties on woolen goods, reckoning together both the specific compensating duty and the supposedly protective *ad valorem* duty, had become extremely high. They had ranged as high as 100 per cent on the few goods that continued to be imported, and were equivalent to 140 or 150 per cent on most foreign goods, which naturally did not continue to be imported in face of these prohibitive rates.

Here is a great decline in rates, — from 100 per cent or more to 35 per cent or less, — leading the public to expect a marked fall in prices. In fact, it is far from clear how considerable will be the change in prices. It is quite certain that the change will not be so great as it would be if, — as is so often assumed in popular discussion, — every cut in duty necessarily brought a corresponding change in price. The duties on woolens, to repeat, had been in the main prohibitory. Domestic woolens had the field to themselves, and competition among the domestic makers kept the prices of most goods within the range fixed by expenses of production within the country. Those expenses of production were unquestionably made higher because the raw

material, wool, was raised in price by the duty. In what degree the strictly manufacturing expenses also were higher than in foreign countries is extremely difficult to make out. If the 35 per cent duty simply offsets higher manufacturing expenses within the country, the change made in the woolen duties will prove but nominal, substituting an effective protecting duty for a needlessly high and prohibitory one.

It would seem that in this case the Democrats strove to apply the competitive principle. The inquiries of the defunct Tariff Board, and some further calculations based upon them, indicated that a duty of 35 per cent would correspond roughly to the difference in expenses of production between American and foreign manufacturers.[1] But the correspondence is only a rough one. On some classes of goods the 35 per cent duty is more than enough to enable the domestic manufacturer to hold his own; other classes of goods will be imported to the displacement of the American product. Predictions of wide-spread diasaster from any such change, such as have been freely made for the last few years will not be fulfilled. No doubt in many cases they have been made in good faith, engendered by the extraordinary exaggeration of the necessity of high protective duties. But usually they have been more or less bluff; those who make them have been concerned chiefly with warding off or minimizing unwelcome changes. The probabilities seem to be that under the 35 per cent rate the greater part of the woolen and worsted manufacture will go on much as before. Some weaker mills may go to the wall. It is freely said, even in manufacturing circles, that the proportion of weaker establishments is in this industry not inconsiderable.

[1] See the excellent article by Mr. W. S. Culbertson, in the American Economic Review, March, 1913, which summarizes the results of the Tariff Board's investigations and adds some valuable calculations of his own.

Those mills which are well equipped and well managed will probably hold their own. But they will have to adjust themselves to new conditions, and may go through a trying period of transition. The "cutting up trade" (the manufacturers of ready made clothing, who are the largest buyers from the mills) will doubtless experiment with foreign and domestic goods, will buy more or less sparingly until it appears what will be the relative prices of the two, and will compel a sharper rivalry among the manufacturers. Free wool will make possible the utilization of fibers not previously used, and so the production of new classes of goods. Some time must elapse, possibly two or three years, before it is clear what will be the situation of the woolen industry under the new conditions.

In any case it is probable enough that some branches of the domestic woolen manufacture may have to be given up. To a layman, the evidence indicates that the makers of the finest goods and of the cheapest goods are most in danger. The so-called standard medium goods, to which the bulk of the manufacture is given, will probably hold their own. The finest and most expensive grades of men's cloths and women's dress goods seem most likely to be imported in considerably larger volume, and to supplant the domestic goods. Some foreign manufacturers, especially Germans, who have transplanted their establishments to the United States under the temptation of the high rates of 1897 and 1909, will apparently suffer severely.

If the forecast just made is confirmed by the course of events, it will follow that no great change in the price of woolen goods is to be expected. Some reduction will ensue because of the lower price of wool; some further reduction perhaps because of keener competition between domestic and foreign manu-

facturers, and sharper conduct of the industry by the former. A more incisive reduction of the duty on woolens, bringing it much below the 35 per cent rate, might indeed lead to far-reaching changes; but nothing of the kind has been done, and is not in prospect for the visible future.

On cotton goods the reductions are not dissimilar in character and in effect from those in the *ad valorem* rates on woolens. The change on the statute book is great; the figures go down sharply. But in this case also the consequences in trade and industry are much less considerable than in the figures.

The rate on the lowest counts of cotton yarns is but 5 per cent. On the cheapest grade of unprinted and unbleached cotton cloths, it is 7½ per cent. For finer grades, the rates rise progressively, the highest on yarns being 25 per cent, and on plain cloths 27½ per cent. An additional duty of 2½ per cent is imposed in all cases on cloths which are bleached, dyed, printed, or mercerized. The maximum duty on cloths is thus 30 per cent. On ordinary hosiery, the rate is 20 per cent; but on hosiery that is fashioned and shaped comparatively high duties are retained, — 30 per cent if the value is 70 cents per dozen or less, 40 per cent if the value is between 70 cents and $1.20, 50 per cent if the value exceeds $1.20. This is one of the comparatively few cases in which the fence system (abrupt steps in the rate of duty, when goods get beyond a given value point) is retained. Cotton knit goods, in general, are dutiable at 30 per cent, and the drag-net clause (manufactures of cotton not otherwise provided for) has 30 per cent. Cotton gloves, which had been affected by one of the jokers of 1909, are dutiable at 35 per cent.

These figures, to repeat, make very radical changes from those previously on the statute book. But, to repeat once more, on most of the goods the reduction will be nominal. The cheaper grades of cottons are produced in the United States as cheaply as in any country. Barring occasional specialties, no such goods are imported. They are exported from the United States, not imported. Goods of medium grade, tho not exported, would hardly be imported in considerable quantities even under complete free trade; and the *ad valorem* duties now imposed will continue to keep the domestic market securely in the hands of the American manufacturers. It is the finer grades of goods that are most likely to be affected. The importation of these had continued even in face of the previous high duties, and is likely to be stimulated by the lower rates. It is these also which had been most affected by the specific duties of the earlier tariff acts. The adjustment of the specific duties had been undertaken at the behest of the domestic manufacturers, or at all events at their suggestion, and had been so devised as to impede most effectively the competition of the foreign manufacturers. No doubt in most of these cases the duties were needlessly high. They were prohibitory, as they were in the case of woolen goods; and the continuing importations consisted largely of specialities which held their own in the market notwithstanding prices much enhanced by the duties. In the case of the finer cotton goods, as in that of the finer woolen goods, there will be some displacement of domestic products by foreign. It must remain to be seen how great that displacement will be.

All the duties on cotton goods are now assessed by value. Except for the retention of a remnant of the fence system in the hoisery duties, not a specific rate

appears in the entire schedule. This radical change was made the occasion for severe criticism, on the familiar ground that *ad valorem* duties tempt to undervaluation and fraud. The criticism is not without basis; and yet the adoption of the *ad valorem* system was almost inevitable. It is in no small part the result of abuses in the previous adjustment of the specific duties. The cotton schedule had been a highly intricate one, with duties varying according to the count of threads per square inch, the number of yards to the pound, the bleaching, coloring, and staining, and finally with a most elaborate fence system of value points. Just what the whole intricate array signified could be known only to persons conversant with every detail of the industry; that is, chiefly to the manufacturers themselves. It was more than suspected that the manufacturers, in their suggestions to the friendly legislators of former days, had manipulated the rates in such manner as to secure not only high protection, but higher protection than would have been granted if the significance of the rates had been fully understood. Charges of this sort, tho doubtless exaggerated, were not without foundation. In the act of 1909 itself, which had professed to reduce duties, some changes had been made, and more had been attempted, for increasing the intricate specific duties in a fashion not straightforward.[1] In view of this familiar situation, it was to be expected that the Democrats should cut loose once for all from the specific system, and substitute *ad valorem* duties, which tell their tale on their face. Moreover, the temptation to undervaluation is not likely to be considerable under duties as moderate as

[1] See an article by S. M. Evans in the Journal of Political Economy, for December, 1910, on "The Making of a Tariff Law;" and a note by M. T. Copeland in this Journal, February, 1910, p. 422.

most of those in the new cotton schedule. This temptation becomes progressively greater as duties become higher, and is least when duties are low. Altho no hard and fast rule can be laid down, it is probable that duties of 30 per cent *ad valorem* can be collected on goods of a standard sort as honestly and efficiently as elaborate specific duties. The danger point in these matters seems to be reached with duties as high as 40 per cent, certainly with duties as high as 50 per cent. It is naturally greatest for goods not of a standard character, whose current market prices are difficult to check. It happens that cottons precisely of this kind had been subject to *ad valorem* duties in the tariff acts of former years. As regards these, the difficulties are made less rather than greater, since the *ad valorem* rate is lowered; while on the goods formerly subject to specific duties, neither the rate nor the character of the goods is such as to make the system unworkable.[1]

The duties on silks are readjusted on the same principle as those on cottons. *Ad valorem* duties are substituted throughout for specific. The general rate on silk fabrics is made 45 per cent; on velvets and plushes, it is 50 per cent. In the Senate, amendments were inserted retaining (tho with some reductions) the previous system of rates by the pound. But the House refused to concur in these amendments and the act as finally passed swept away almost every specific duty in the silk schedule.

In this case also the abolition of specific duties is to be ascribed to a feeling of suspicion concerning their intent and real effect. The highly complex

[1] Cf. what is said below (p. 26) on the administrative sections of the act and the collection of *ad valorem* duties.

system adopted in 1897 and retained in 1909 had been devised nominally by the custom officials, but at the least with the advice and concurrence of the manufacturers. The plea which was advanced for the change from *ad valorem* to specific rates was that thus only could undervaluation and fraud be prevented. Beyond doubt undervaluation had been common and sometimes flagrant. Beyond doubt, also, it was lessened after 1897; tho by no means entirely prevented, since under the dragnet clause a considerable part of the imports still remained subject to an *ad valorem* duty.[1] On the other hand, so intricate was the classification, so fine and minute were the lines of gradation in the specific duties, so troublesome was it to check inaccurate and even fraudulent statements, so difficult to find competent supervisors at the meager salaries offered by the government, that the working of the new system seems to have proved in practice not greatly superior to that of the old. But these administrative difficulties were not decisive in bringing about the complete return to the old *ad valorem* plan. It was tolerably certain that the elaborate specific duties contained some "jokers"; and any readjustment of them, calling of necessity for advice from the same persons that had planned them at the outset, was likely still to retain jokers. The certain method of getting rid of this wretched adjunct of the tariff legislation of the past was to maintain *ad valorem* duties throughout. These have at least the advantage of telling their own tale plainly.

The rates on silk fabrics are left comparatively high, — on most goods, 45 per cent. The reductions

[1] All silks on which the specific duties did not amount to much as 45% or 50% (the rate varied on different goods) had been left dutiable at these *ad valorem* rates as minima.

are by no means so great as those on cottons and woolens. This remains true, even after making allowance for the circumstance that a duty of 45 per cent is much more likely to be shaved by undervaluation than is one of 30 per cent; making allowance, too, for the further circumstance that the unusual variety in silk fabrics makes it difficult to check importers' statements of market value and impedes the detection of undervaluation. The silk manufacturers got off easily. The explanation apparently is that silks were regarded as luxuries, and therefore properly subject to duties higher than on other textiles. It need hardly be said that if taxes on luxuries are to be imposed on strict revenue principles, and with the design of reaching persons who can well afford to pay, they should be imposed upon the domestic article as well as upon the foreign. To fix a customs duty, for purposes of revenue, at a point so high as greatly to impede importation, almost prohibit it, is obviously stultifying. There is ground for suspecting that something precisely of this sort has been done in the case of the silk duties. They remain prohibitory on most silks. A lower range of rates would probably have yielded more revenue, and would have been more in accord with the competitive principle.

The silk manufacture, as it happens, has reached the stage where there is good ground, on other than bare revenue principles, for a reduction of duties. It has had for half a century an unusually high degree of protection. It has grown with extraordinary rapidity to very great dimensions. Its character has been entirely changed. The development has been not only quantitative but qualitative. It may present a case, — I am not convinced that it does, but at least the possibility is present, — of successful protection

to young industries. The duties have become prohibitory on most silk goods, as they have on woolens. The rates could have been reduced much more without disturbance to the bulk of the industry. The time seems to have come for application of at least some approach to the final test in the young industry argument, — an incisive reduction of duties, in order to ascertain whether the industry leans less on protection than when first supported, and has made progress toward eventual independence.

Another schedule upon which the reduction of duty was less than might have been expected is that on pottery and earthenware. Here also duties have been left comparatively high, apparently on fiscal grounds. The changes in rates on the significant articles are as follows: —

| | Act of 1909 | Act of 1913 |
|---|---|---|
| Earthenware and crockery, not colored or ornamented | 55% | 35% |
| Crockery, colored or ornamented | 60% | 40% |
| China and porcelain ware, not colored or ornamented | 55% | 50% |
| China and porcelain ware, colored or ornamented | 60% | 55% |

The cheaper grades, classed as earthenware and crockery (whether plain or ornamented) are largely produced in the United States. The imports are not inconsiderable, yet the domestic manufacturers in the main hold the field. The case is the reverse with the finer grades, — china and porcelain ware, — on which it will be seen that high duties have been retained. These are chiefly imported, and may be fairly regarded as articles of luxury. The duties on them are mainly revenue duties, and there is no reason why they should not be left as high as they are. No doubt the problem

of undervaluation remains. It has been the occasion of no little trouble in the past, and will probably continue to be in the future. On earthenware and crockery proper, where the duties have been left at 35 and 40 per cent, the situation is different. These are distinctly protective duties, and moreover are so high on many grades as to be prohibitory. On the competitive or fiscal principle, it would seem that, like the silk duties, they might have been lowered even more than has been done.

The duties on iron and steel caused comparatively little debate, as had been the case in 1909. It has become more obvious than ever that the center of interest in the protective controversy has shifted from the iron schedule to others, especially to schedule K (wool and woolens). The progressive reduction of duties which has gone on since 1890 has been carried a stage further. Not only iron ore is made free of duty, but also pig iron, scrap iron (already made free in 1909), iron in slabs and blooms, Bessemer steel ingots, and those forms of crude iron which are used for admixture in the steel making processes, such as spiegeleisen and farro-manganese. Barbed wire and galvanized wire, such as is used for fencing, also is free: a concession to the farmers which, under the actual conditions of supply, is of no real consequence. Steel rails are on the free list. Moderate *ad valorem* duties are imposed on other manufactures of iron, rising as the products became further advanced beyond the crude stage. Bar iron, for example, is dutiable at 5 per cent, steel bars at 8 per cent, structural shapes at 10 per cent. Tin plate, that old bone of contention, gets 15 per cent; tubes and pipes, 20 per cent. The dragnet clause, on manufactures of iron and steel "not otherwise provided for," imposes 20 per cent, —

no small reduction from the previous duty of 45 per cent. Most of these changes signify little. There may be an increase in the importation of certain specialties; and some seaboard regions, more easily reached from abroad by water than from the centers of domestic production by land, may import sporadic supplies of crude iron. In the main, the course of production within the country, the sources of supply, the range of prices, will not be affected. The time has gone by when the protective system was of real consequence for the iron and steel industries. For good or ill, it has done its work.

Some minor items may be briefly noted. Hides, made free in the act of 1909, after so hot a debate, of course remain free; and now leather, and boots and shoes as well, are added to the free list. Wheat and flour, cattle and meats are also free. In the House an endeavor was made to retain duties on wheat and cattle, while abolishing those on flour and meats; an attempt to relieve the consumer and yet keep a show of protection for the farmer which was obviously stultifying. Good sense prevailed in the end, and the duties on all these food products are swept away. The change is not likely to be of moment for some time in the future, — barring some border trade, and occasional importations in bad seasons. It is among the possibilities, no doubt, that eventually there may be more serious consequences. Eggs, milk, cream go on the free list: again articles in which only a small border trade will be encouraged. Coal and lumber also go on the free list at last; the remnants of duties retained in 1909 are swept away.

Books chiefly in foreign languages remain untaxed, notwithstanding an unintelligent attempt to subject them to duty. But now "all text books used in

schools and educational institutions" also are put on the free list. Wearing apparel and personal effects of travellers "necessary and appropriate" for use, are free without limit of value; and in addition residents of the United States returning from abroad may bring in $100 worth of articles "for personal or household use or as souvenirs or curios."

A general anti-dumping section is maintained, substantially the same as that in the tariff act of 1909. The Secretary of the Treasury is authorized to impose additional duties equal to the amount of any grant or bounty on exportation given by any foreign country. The provisions for maximum and minimum duties, which played so large a part in the debates on the tariff of 1909, are dropped entirely.

The wide use of *ad valorem* duties has called for a revision of the administrative sections. This part of the tariff has given occasion for constant patching, from 1789 to the present. Even in the acts of 1890, 1897, and 1909, in which *ad valorem* duties were replaced by specific wherever thought feasible, so many of the former remained that in each successive measure the provisions against fraud were made more stringent or new administrative features devised. In 1890, the Board of General Appraisers was established, having power to decide definitively on questions of fact which previously had gone to the courts and had clogged them. In 1909, the Court of Customs Appeals was established, with exclusive jurisdiction over the strictly legal questions arising under the customs acts. It is surprising, in view of the strong desire of the then dominant party to strengthen the protective system, that the provisions concerning declaration, valuation, collectors' powers, and the like, should still have left

many loopholes for the dishonest importer. Yet such was the case; and modification of the sections covering these matters was still necessary in 1913. It is but just to note that the Taft administration had given consideration to the same problems, and had appointed committees of administrative officials to recommend improvements. The Democratic Committees, under Mr. Underwood's leadership, also gave them earnest attention. The pertinent sections of the tariff accordingly are largely rewritten. That they are substantially improved is the judgment of specialists competent on this intricate subject.[1] The penalties for fraud are made, not indeed heavier, but more certain; litigation on contingent fees (a great abuse) is prohibited; the powers of collectors are strengthened. A clause that aroused strong opposition seeks to give opportunity for the examination of the books of importers and foreign manufacturers suspected of dishonest practices. After much discussion, and vehement protest from persons interested, the clause was so framed as to give the Secretary of the Treasury discretionary authority to impose an additional duty of 15 per cent in cases where there is refusal to submit books and records. On other matters also a discretionary power is given the Secretary of the Treasury: a mode of procedure much wiser than that of rigid prescription by law. Not of least interest to economists and others having occasion to study the course of foreign trade are provisions for the better collection and arrangement of the statistics of imports. There has been ground for suspecting these of serious inaccuracies.

On the whole, the administrative provisions are well drawn. How far they will succeed in making the

[1] See the analysis of these sections made elsewhere in the present issue (see p. 31) by Mr. James F. Curtis, who was the efficient assistant secretary of the Treasury in charge of these matters under the Taft administration.

new system work satisfactorily remains to be seen. As has already been said, no great trouble is likely to arise when the rates do not exceed some such figure as 30 per cent. But when goods are subjected to *ad valorem* duties as high as 45, 50, 55, even 60 per cent (for example, silk piece goods, silk apparel, china ware) the temptation to evasion becomes so strong that all the penalties in the world will not entirely prevent it. If specific duties are abandoned because deemed suspicious or impracticable, the only safe administrative policy is to keep the *ad valorem* rates moderate.

It has been pointed out time and again, in the preceding pages, that many reductions of duty made in this act of 1913 are likely to be without real effect. They serve to lower duties that have been prohibitory or abolish duties that have been nominal. Much the larger part of the changes are probably of this sort. Can it be said that they are worth while?

Beyond question, the consequences in industry and in prices that will ensue have been immensely exaggerated by both sides. Such exaggeration is the inevitable result of the tariff's having become an issue in elections. And apparently the tariff question cannot be other than one of party politics. It is enveloped in partisan controversy quite as much in England, Germany, France; and in these countries also the economic effects of protection are constantly over-stated. In our own country, the main channels of industry and trade have not been seriously deflected by the tariff system. The great bulk of our occupations would be conducted in the same way even under complete free trade. Such modifications as are now made in the tariff will call for readjustment in only a small fraction of the whole field of industry. And

by the same token, they will lower prices comparatively little. The expectation that the cost of living will be substantially lowered is doomed to disappointment.

None the less, it is worth while to make the changes; not only those of real consequence, but those of merely nominal effect. It is worth while, if for no other reason, because it may fairly be expected to put an end to the superstition that all prosperity is dependent on the maintenance of a rigid protective tariff. This superstition was indeed somewhat shattered by the crisis of 1907, and the period of depression that followed. But it has been so dinned into the public ear, — there have been such vociferous predictions of general disaster, of collapse for all manufacturing enterprises, of destruction to the American standard of living, — that it is well to prove the industrial organism quite able to survive this general pruning. A more sober consideration of the tariff question may be expected to follow a proof its comparative unimportance, and then a greater attention to the social questions which constitute, after all, the inexorable problems of the century.

And yet, it may conceivably turn out that the old superstition will be strengthened, not put an end to, by the course of events under the tariff of 1913. An immense deal will depend on the accident of good or bad times during the years of President Wilson's administration. I say accident, meaning that in this regard the tariff itself will be of but little influence. The turn toward prosperity or the reverse, — as the case may be, — will depend on factors quite different. Tho we are much in the dark concerning the causes of the periodic alternations of activity with depression, every competent observer will agree that among these

causes tariff legislation is the least important. But the average person reasons, or rather feels, differently. If we have bad times for the next three or four years, he will hold the low duties responsible; if we have good times, he will give the low duties the credit. As is proved by the experience of 1846–57, and again by that of 1897–1907, a period of general prosperity leads to an acceptance of the existing tariff as satisfactory, whether it be one with a low range of rates or a high one. So it will doubtless be with the tariff of 1913.

Hence those who believe that our protective system has been partly misdirected, partly outgrown, — the cause in some degree of unhealthy industrial development, but in even greater degree of political jobbery and exasperating fallacies, — will pray for good times in the immediate future. The juncture would seem not unfavorable. The country is not, as it was in 1894, in the initial stages of a period of depression. It would seem to be rather in the middle of the usual cycle, and ready for an upward swing. But he would be rash who counted too confidently on the repetition of the precise sort of oscillation which has appeared in previous industrial cycles, or ventured to predict that this year or the next would usher in a stage of activity and prosperity. The event must be awaited; and the tariff of 1913 must take its chances of being held responsible for an outcome on which, after all, it can have little influence.

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# THE ADMINISTRATIVE PROVISIONS OF THE REVENUE ACT OF 1913[1]

## SUMMARY

The great use of *ad valorem* duties in the act, 31. — Action of House and Senate, 33. — Consigned and assembled shipments, 33. — Forms of declaration at Secretary's discretion, 34. — Better statistical returns, 34. — Penalties strengthened, 35. — Some hardship for importers obviated, 36. — Ascertainment of foreign value, 38. — Protest fees required; contingent attorney fees prohibited, 38. — Character of hearings before General Appraisers, 40. — Fictitious cases by domestic manufacturers prevented, 41. — Penalties, 42. — Burden of proof in suits for value, 43. — Provisions on examination of books of foreigners and importers, 44. — Conclusion, 45.

ONE of the most striking features of the new tariff is the wholesale adoption of the *ad valorem* method of assessing duties. Much may be said upon each side of the question of the rival merits of the *ad valorem* and the specific bases for levying duties; and Secretaries of the Treasury have differed fundamentally upon this question. But there can be little discussion upon the relative difficulties of administration of the two, or upon the ease with which frauds may be practised upon the revenue. The *ad valorem* method throws far greater difficulties in the path of the Treasury Department, both at the custom houses and abroad, and also immeasurably increases the opportunities, temptations, and facilities for fraud upon the part of the importer. As was aptly said by one of the ambassa-

[1] The revenue act of 1913 is entitled "An Act to reduce tariff duties and to provide revenue for the government, and for other purposes." Section I fixes the tariff duties. Section II levies the income tax. Section III, the one here under consideration, settles the administrative details of the tariff. Its paragraphs are listed under capital letters, A, B, C, D, and so on. Section IV contains miscellaneous provisions, — on trade agreements (quite innocuous); modifications affecting Cuba, the Philippines, and Porto Rico; drawback arrangements; and so on, in considerable number.

dors at Washington from a foreign country where the specific method has been adopted; "We think our collectors can tell a pair of shoes from a grand piano very readily": and he might have added, "and from a gallon of whiskey, or a ton of coal, or a yard of cloth, and can count, gage, weigh, or measure them with ease and exactness." On the other hand, it is no simple matter for an appraiser in Cleveland, let us say, to ascertain with entire accuracy the exact value of a bale of wool in Afghanistan upon a day months past (the day of shipment); which is the job that is required of him under the *ad valorem* system. And this job, the Underwood Act has increased to a somewhat terrifying extent. For example, Schedule A, comprising chemicals, oils and paints, included eighty-three paragraphs in the tariff of 1909, of which fifty-eight were specific, eleven *ad valorem*, and fourteen both specific and *ad valorem*. The same Schedule in the act of 1913 includes seventy-one paragraphs, of which only twenty-two are specific, thirty-two being *ad valorem* and sixteen being both specific and *ad valorem*. And this illustration is typical of the whole measure.

Now it early became obvious to Mr. Underwood and his associates that the proper protection and collection of the revenues upon the *ad valorem* basis would require a clothing of the collecting force with all the powers necessary to prevent and punish frauds in undervaluation. As a natural consequence the administrative sections, which found their origin in the Customs Administrative Act of 1890, amended in some particulars by the Dingley act of 1897, and the Payne act of 1909, were gone over with the utmost care in order that the weak places might be strengthened and the powers of the government to get at the truth in matters of valuation might be made clear and summary.

Altho the Sub-Committee of the Senate, influenced to a large extent by a committee purporting to represent the sentiments of the Merchants Association of New York, apparently became imbued with the idea that a "conspiracy" existed to defeat the object of the lowered duties by harsh administrative provisions, and eliminated a larger number of the reforms found therein, a substantial number have been restored by the conferees and now appear in the law.

The first of these changes is found in paragraphs C and D of Section III. This amendment requires that there shall be included within the general description of "purchased" merchandise, all articles concerning which "agreements for purchase" have been made, altho title has not actually passed. The purpose of this change undoubtedly was and its effect will be, to prevent the importation, upon a "consigned" form of invoice, of merchandise which has actually been made the subject of a bargain and sale. Thus the appraising officer will have the benefit of an intimate knowledge of the real transaction concerning the goods imported, a knowledge which in many instances he had been prevented from obtaining under the old law.

Paragraph D also contains an amendment requiring the consulating of an invoice in the consular district where the merchandise is assembled for shipment, in cases where purchases are made in more than one district. This will obviously tend to avoid the present uncertainties as to the correct procedure in such cases and will benefit both the shipper and the government. It may be noted at this point that a later paragraph (X) amplifies the provision on assembled merchandise, by requiring that such invoices shall have attached thereto the original bills, invoices, or statements,

showing the prices or expenses of each purchase or consignment. This will add materially to the labor required of the shipper of assembled merchandise, but it will only give the appraisers the amount of information to which they have always been entitled, but which they have been unable to get in many instances.

The next important change is found in paragraph F, which abolishes the four rigid statutory forms for declarations which have heretofore been mandatory. In their stead is a provision that the declaration accompanying the entry shall be upon a form "to be prescribed by the Secretary of the Treasury according to the nature of the case." This amendment will give flexibility to the requirements for declarations and will permit the Secretary to provide proper forms to cover the constantly changing conditions of business, and will require the importer to make a declaration true both in letter and spirit, — a requirement that is today not always possible of fulfilment.

There is added to the paragraph also an authorization to the Secretaries of the Treasury and Commerce to establish lists of imported articles for statistical purposes, which must be used in making out the declarations upon entry; and it is made the duty of the consular officers to require such statistical information to be furnished at the time of consultation of the invoice. This reform is undoubtedly the result of the efforts of a joint committee of the Departments of the Treasury and of Commerce and Labor which had been at work for more than a year during the last administration upon the problem of improving our statistical returns of imports and exports. While it will require some additional clerical labor on the part of the foreign shippers and our own importers, it will be of considerable value in augmenting the accuracy of our statistics, hitherto woefully lacking in that regard.

Paragraphs G and H, which provide the penalties, criminal and civil, for fraudulent entries, replace subsections 6 and 9 of Section 28 of the Payne act. Each paragraph has been strengthened in order to bring within its terms various fraudulent acts of importers which have heretofore escaped without penalty, owing to loopholes or weaknesses in the existing laws. The changes are aimed principally at the practice, so common hitherto, of having the entry and the declaration made by an office boy or an agent or broker, acting for the importer, from whom all knowledge concerning the facts of the transaction is carefully kept. Under the old law it was practically impossible for the government to fix the liability for frauds thus accomplished; now the person who makes the entry and every person who aids or procures its making will be held strictly accountable for the truth of the facts therein recited. In other words, the new law has real teeth, to take the place of sham ones that had been filed away by court decisions. Importers and their agents would do well to study the provisions of these paragraphs before making entry, for while they do not require anything more than the exact truth, they do require this, without equivocation. Incidentally there is an added proviso which will prevent what are called "general order" goods from retaining the immunity from forfeiture which they now apparently enjoy. That is, merchandise which has been shipped from abroad accompanied by a false invoice, but of which no entry has been made at the port of arrival, will be held to be the subject of an attempt to enter by fraud, and consequently liable to the ordinary forfeiture provisions. Under the old law (unless a case now on appeal in the Supreme Court should be reversed) an importer whose fraud was discovered prior to the arrival of the goods,

could escape all consequences by merely letting them go, without formal entry, to the "general order" warehouse.

Two changes are made in Paragraph I. The first is of no real importance, — an insertion to the effect that an importer may make an addition or deduction to or from the invoice value of his merchandise at the time of making entry "but not after either the invoice or the merchandise has come under the observation of the appraiser." The change in language from the act of 1909 is slight, and in practical administration will be nil, as a practice had grown up under the rulings of the Treasury Department by which the language of the Payne law was construed to mean exactly what is now inserted in the Underwood bill. A very substantial amendment, however, made in conference, provides that an importer may, by direction of the Secretary of the Treasury, have his duty assessed upon an amount less than the entered value, provided that the importer certifies at the time of entry that the entered value is higher than the foreign market value, and that the goods are so entered in order to meet advances by the appraiser in similar cases then pending upon an appeal for re-appraisement, and provided further that the importer's contention shall be sustained by final decision upon such re-appraisement, and it shall appear that his action was taken in good faith after due diligence and inquiry upon his part. The Secretary is also required to accompany his directions with a statement of his conclusions and his reasons therefor.

Undoubtedly this provision will prevent the hardship under which a few importers were placed by the provisions of the Payne law in cases where they have had an honest disagreement with the appraiser's officers as to the true value of the imported merchandise.

Under the Payne law (which is copied exactly in this section of the Underwood bill, with the above proviso added) if an entry is made at too low a valuation, and is raised by the appraiser and sustained by the general appraisers upon appeal, the importer must not only pay the increased duty to be assessed upon the higher valuation but also an additional duty of 1 per cent for every 1 per cent of undervaluation, not exceeding 75 per cent in all. This general provision was and is necessary for the adequate protection of the revenues against under-valuations. On the other hand, there is a further provision that duty in no case shall be assessed upon a value less than the entered value. The result of the two is that while the case is on appeal before the Board of General Appraisers the importer who brings in more merchandise of the same character is literally between the devil and the deep sea. If he enters his merchandise at the lower value which he claims is correct, and his contention is finally held invalid, all his entries are liable to both the increased and the additional duties described above. On the other hand, if he makes an entry at the valuation claimed by the appraisers, and their contention is finally held invalid, he can get no rebate but must pay with respect to all the entries upon a value not less than the entered value. In attempting to relieve the harshness of this situation Congress has thrown upon the Secretary of the Treasury a responsibility which in a modified form has been tried before and abandoned, and which will very likely lead to many charges of favoritism and undue influence. It will tend to encourage every importer to place a low valuation upon his merchandise, contest by appeal all such increases as may be made by the local appraisers, file the required certificate of good faith and due diligence, and hurry to the Secretary of

the Treasury with a request that all his merchandise be allowed entry at the lower rate. Should that rate in the test case be sustained, the Secretary, or rather the Assistant Secretary in charge of the customs (for upon his shoulders will fall the burden of this Section) will then have to decide as to the good faith and general merits of the claims put forward by a number of importers, altho he is without adequate machinery or time to hold hearings under oath in this regard. The amendment undoubtedly will cure the evil that sometimes but not very frequently occurs. Whether or not it will plunge the Treasury Department into worse evils is a question which cannot be answered without an actual experience of its administration.

The next change appears in paragraph L, which is the paragraph authorizing appraisers in cases where merchandise is not actually sold or freely offered for sale in the open market of the country of exportation to ascertain the foreign market value by deducting from the actual selling price in the United States, the estimated duties, cost of transportation, insurance, and other necessary expenses, a commission not exceeding 6 per cent, and profits not to exceed 8 per cent, and a reasonable allowance for general expenses not to exceed 8 per cent. The Payne law allowed a maximum of 8 per cent for both profits and general expenses. The Underwood bill is more liberal to the importer in this regard and allows a maximum of 8 per cent for each.

Paragraphs M and N, relating to the duties of the appraiser and the general appraisers in re-appraisement cases, have been altered in a number of particulars. An important change is that requiring a fee of one dollar for carrying an appeal for re-appraisement to the Board of General Appraisers. The House Bill had provided that this fee should be payable " with respect to each

appraisement objected to." This was stricken out by the Senate and in conference a compromise was reached to the effect that the fee should be "for each entry." While this is an improvement upon the old law, under which importers might appeal for re-appraisement to their heart's content without cost to themselves, it is not so effective as the House proposal, in view of the fact that some invoices and entries cover hundreds of sheets of paper and include thousands of items, all of which may have different values and classifications. The same criticism may be made of paragraph N, where the House provision limiting each protest to a single article or class of articles and to a single entry or payment was stricken out by the Senate. It is not reasonable that an importer who makes an entry of one article of merchandise should be called upon to pay the same fee for appealing for re-appraisement or re-classification as an importer who appeals with respect to several hundred articles of merchandise which happen to be included in one invoice and entry.

The requirement of a protest fee is a reform urged for years by the Treasury Department during all the recent administrations; it was recommended by the Denison Committee and also by the Appraisement Commission appointed by Secretary MacVeagh; and it was also recommended by most of the members of the Board of General Appraisers. The experts in the customs service confidently expect that the enormous mass of customs litigation will be more than cut in half, and that the dockets of the Board of General Appraisers, heretofore clogged with over one hundred thousand protests per year, will now be filled with only *bona fide* cases brought to test some real issue between the importer and the government.

A second new provision bitterly opposed by customs attorneys and brokers is that "no agreement for a contingent fee in respect to recovery or refund under protest shall be lawful," and "compliance with this provision shall be a condition precedent to the validity of the protest and to any refund thereunder," and further that "a violation of the provision shall be punishable by a fine not exceeding $500, or imprisonment of not more than one year, or both." This change was also urged by the Denison Committee, and was submitted to the Finance Committee of the Senate by Assistant Attorney Denison and by the present writer, with the approval of Secretary McAdoo. It is aimed at a grave abuse, amounting in the opinion of many to a scandal, caused by the general practice prevalent today of customs attorneys and brokers taking cases for importers upon a 50 per cent contingent fee basis. The practice has led not only to the fomenting of litigation, but also (since the longer the litigation is dragged out, the better it is for the lawyer, but worse for the importer) to a situation in which the interests of the attorney and his client were diametrically opposed in the matter of pressing the case to a final conclusion.

Paragraph M has been further amended so as to eliminate closed hearings before the Board of General Appraisers. At all such hearings the parties or their attorneys shall have opportunity to introduce evidence and to hear and cross-examine the witnesses for the other parties, and to inspect all samples and all documentary evidence offered. This provision by itself would indicate that the procedure to be adopted by the Board of General Appraisers would be approximately that of a Court or Judicial Tribunal; but it is also provided that evidence of persons whose attendance cannot be procured may be admitted in the discretion

of the Board and that the Board is authorized to exercise both judicial and inquisitorial functions. The provisions of the bill as it passed the House indicated clearly that the Board was expected to be an appellate tribunal for appraisements, exercising independent and inquisitorial means of its own for ascertaining values. The House had adopted the theory, which has been heretofore followed, and which was urged in the report of the President's Committee (composed of Messrs. Denison, Loeb and Frankfurter) to investigate the Board of General Appraisers, that any appellate tribunal on appraisement matters should add to the stock of knowledge and evidential facts concerning values. The paragraph as it came from the Senate indicated an intention to turn the Board into a judicial body. The result reached in conference is obviously a compromise. The Board is clothed with some powers like those of a court, but is still authorized to exercise inquisitorial functions like a local appraiser or other administrative officer. The net result will probably be that the hearings before the Board will be conducted in the future much as they have been in the past.

Another amendment (in paragraph N) is aimed to overcome the decisions of the Court of Customs Appeals in the Schwartz case, in which it was held that a domestic manufacturer who desired more protection for his product than the government was assessing, might import similar articles and protest because the rate or amount of duty assessed upon his merchandise was too low. The effect of this decision was to encourage fictitious litigation, which will be prevented by the new language authorizing the filing of a protest if the importer is dissatisfied with a decision "imposing a higher rate of duty or a greater charge than he should claim to be legally payable."

Importers should not feel, however, that the whole of these paragraphs has been turned against them, for there is one provision more favorable than the similar one in the old law, that relating to the time within which a protest must be filed. This period has been extended from fifteen days to thirty days after the final liquidation of the entry: and it should be noted that the "iniquitous" protest fee need not be paid for thirty days more, — a total of sixty days within which the importer may decide whether he desires to litigate with the Government or not. This period should easily suffice for all *bona fide* cases.

Paragraph O has been amended to meet a court decision to the effect that collectors and appraisers were not entitled to examine importers and other persons regarding merchandise not directly before them for consideration and action. The new law provides that the officers may make such inquiries respecting goods "then under consideration or previously imported within one year." This change is clearly in line with the policy of strengthening the powers of the government wherever experience has shown such action to be necessary. There is also a slight amendment to make certain that the testimony of persons taken by the collector or appraiser in advance of the formal hearing shall be given consideration in subsequent proceedings. While this was probably the intent of the old law, the language was not entirely free from ambiguity. The provision is especially useful in obtaining the evidence of masters and crews of vessels or other persons, whose later attendance at any given place in this country is difficult to obtain.

The next paragraph (P) specifies the penalties for a refusal to attend when summoned, or to answer the authorized interrogatories.

The changes here are two. The first substitutes a fine upon the recalcitrant witness varying from $20 to $500, for the former flat amount of $100. The second, more important, provides for the recovery by the government of the value of the merchandise in question from the witness if he is the owner, importer or consignee. The old law had provided only for forfeiture in such cases, and had not authorized a suit for value in instances where the merchandise might escape forfeiture by having actually entered into consumption.

Slight alterations in language appear in paragraph Q, making clear the intent of Congress that the Secretary of the Treasury and the Board of General Appraisers are to have joint control over the publication of the decisions of the Board, either in full or by means of abstracts. A more significant change, however, is found in a new phrase requiring the Board to insert in its decisions "a statement of facts upon which the decision is based." This amendment will not affect classification cases at all, as the present practice of the Board is to include such a statement; but it will make a vital change (and greatly for the better in the opinion of the writer) in all re-appraisement cases. Heretofore, the General Appraisers, in reporting such cases, have not stated the facts which led to their decisions. In consequence the decisions were almost never of benefit in assisting either the local appraisers or the importers in arriving at correct values for later importations of similar merchandise.

Another amendment, somewhat similar to that found in paragraph P, appears in paragraph T, whereby the burden of proof is thrown upon the defendant in suits for value, just as the burden is already upon him in forfeiture cases. The only difference between the two types of proceedings is that in one the merchandise is

actually seized, whereas in the other it has escaped seizure by having entered into consumption. As recovery by the government in each class of case is predicated upon fraud, it seems entirely proper that the defendant who has been astute enough to get his goods away from the clutches of the Customs officers should not thereby be placed in any better position than a brother importer who has not had that good fortune.

Paragraph U is one of the new provisions, originating in the House bill, that caused much adverse comment both in this country and abroad. In its original form it authorized the Secretary of the Treasury to exclude from entry merchandise sold or shipped by foreigners who declined to submit their books pertaining to values or classifications to a duly accredited officer of this country. The Senate struck out the paragraph (which was wholly new) in its entirety. In conference a substitute was adopted authorizing the Secretary to levy an additional duty of 15 per cent upon all such merchandise, with a proviso, however, that such additional duties shall not be imposed upon merchandise from foreign countries where there exists legal machinery for punishing false swearing upon invoices or statements of costs in connection with the consular certification thereof. As thus enacted the paragraph gives the Secretary a power (altho not a very extensive one) which he will certainly need if the *ad valorem* system is not to break down of its own weight. It will also tend to hasten the day when adequate penalties for perjury committed abroad with reference to exported merchandise can be inflicted upon the guilty parties. At the present time there are very few countries where such is the case (possibly one or two in all).

Paragraph V, as framed in the House, provided for the same penalty of exclusion for the merchandise of

importers in this country who refused to open their books. This also was stricken out by the Senate, and finally modified in conference to a penalty of 15 per cent to be imposed at the discretion of the Secretary.

To conclude, the new law is clearly designed to protect the government and assist its officers in collecting the revenues justly due. The burdens imposed upon the honest importer who desires to comply with both the spirit and the letter of the law have not been greatly increased. It is true that he must make a statistical list of his imports, but the forms will be prepared for him by the Department, and the task should prove little if at all more exacting than the present requirement that every invoice shall contain an accurate detailed description of the merchandise covered. True, also, he will have to take far greater pains to make sure that his entries are made and verified by a person with actual personal knowledge of the facts therein recited. Under the old system, such entries were ordinarily made by a subordinate who, to quote the report of the Appraisement Commission "supports the integrity of the invoice by his declaration to the best of his knowledge and belief, without having the faintest semblance of knowledge or the frailest foundation for belief." This situation cannot exist under the new law unless both the principal and his agent are prepared to assume severe liabilities in case improper entries are made. Drastic provisions and heavy burdens, however, are prepared for the dishonest importer, who will be made to feel much more keenly than has heretofore been the case that the law is meant to be obeyed and not to be trifled with.

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# THE INCOME TAX OF 1913

## SUMMARY

The constitutional amendment of 1913 and the new income tax, 46. — I. The "normal" and "additional" taxes; the minimum exempt; the scale of progression, 47. — Dividends exempt from the normal tax, 49. — II. Limited application of stoppage at the source; its possible advantages and disadvantages, 50. — How applied as regards salaries and other single payments, 52. — As regards interest on bonds, 55. — "Fixed and determinable incomes," 56. — III. How minimum exemption is secured, 58. — IV. Return of income required; yet possible exceptions, 61. — V. The "additional" progressive tax, 65. — VI. Conclusion, 66.

Among the notable events of the year 1913, one of the most important in its influence upon the national finances and constitutional development of the United States is the adoption of an amendment to the Federal Constitution giving Congress the power "to lay and collect taxes on incomes, from whatever source derived, without apportionment among the several states and without regard to any census or enumeration." The mere fact that an amendment of any kind has been adopted is notable, this being the first occasion on which the Constitution had undergone any change since the period of the Civil War, and the first amendment adopted in peaceful and normal times since the early days of the Republic.

It is a little remarkable, altho perhaps not altogether accidental, that the adoption of this amendment should coincide with the return to power of the political party whose attempt to levy an income tax in 1894 was frustrated by the decision of the Supreme Court in that year. Then as now an income tax was a component part of the program of fiscal and commercial reform to which that

party was committed. This program included the reduction of protective tariff duties and the direct taxation of incomes. What the Democratic party failed to accomplish in 1894, it has had a free hand to do in 1913. Indeed, the national taxation of incomes might almost be regarded as a mandate of the people of the United States. At any rate, it was a foregone conclusion that the adoption of the constitutional amendment would be immediately followed by the enactment of an income tax law.

The law instituting the income tax was approved October 3, together with the law revising the tariff, both measures being included in one comprehensive statute entitled " An Act to reduce tariff duties and to provide revenue for Government, and for other purposes." It is the object of the present article to give a general description of the income tax. This seems to be especially well worth while because the tax cannot be readily understood from a mere perusal of the involved and sometimes obscure phraseology of the law itself. For the same reason, however, the task of interpretation is not easy or entirely safe. The law has certain novel features; and some of the questions of detail to which they give rise cannot be answered until we have the official construction placed upon the language of the act by the executive branch of the government and possibly by the courts. At the same time the main features of the tax become fairly evident to any one who makes a careful study of the provisions of the act, even tho its application to specific cases may remain doubtful.

## I

The law provides that incomes shall be subject to a tax of one per cent on the amount by which they exceed

the prescribed minimum limit of exemption. This is designated as the "normal income tax." There is then an "additional tax" of one per cent on the amount by which any income exceeds $20,000. The rate is increased to two per cent on the amount above $50,000, to three per cent above $75,000, to four per cent above $100,000, to five per cent above $250,000, and to six per cent above $500,000. Therefore under the normal and additional tax combined, the first $20,000 of income, exclusive of the minimum exemption, will be taxed one per cent; the next $30,000, two per cent; the next $25,000, three per cent; the next $25,000, four per cent; the next $150,000, five per cent; the next $250,000, six per cent; and all income above that point seven per cent. This is a rigorous application of the progressive principle.

The minimum exemption, at the same time, is comparatively high, — $4,000 for a married person and $3,000 for everybody else. The higher exemption in case of the married is conditional upon husband and wife living together, and applies only to their aggregate income; that is to say, it cannot be deducted from the income of each. It may be noted, in this connection, that in England the exemption allowed under the income tax is £160 or $800; in Prussia it is 900 marks, or $225; and in the state of Wisconsin it is $800 for individuals and $1,200 for a husband and wife, with a further allowance for children or dependent members of the family.

The sharply progressive rates and the comparatively high exemption have given rise to the criticism that this is a rich man's income tax and disregards the principle that all persons should contribute to the expenses of the government in proportion to their several abilities. It is often said that an income tax ought to

reach all incomes with the exception of those which are close to or below the minimum necessary for subsistence, and that if people generally were called upon to contribute directly to the government they would take greater interest in public affairs and show more concern over any wasteful or unwise expenditure of public money. In reply it is contended that the limitation of the tax to the wealthy or well-to-do classes is justified because these classes do not pay their fair share of the indirect national taxes, or of local property taxes. These debatable questions lie outside the scope of the present article. It is evident, however, that the income tax should not be criticized as if it were a single tax or formed the only source of revenue for the Federal government. From the fiscal standpoint it occupies a subordinate position in the national finances, being expected to yield about $125,000,000 annually out of a total estimated tax revenue of $680,000,000.

The normal tax of one per cent is to be levied upon the income of corporations. In effect this provision of the law merely continues the corporation or "excise" tax which was already in existence. But that tax now becomes an integral part of the income tax, covering the income which accrues to the stockholder and is distributable in the form of dividends. On the theory that this income is reached at the source by the tax upon the net earnings of the corporation the dividends as such are exempt. They are not to be included, so far as concerns the normal tax, in the taxable incomes of the individual stockholders and the law does not provide that the tax paid by the corporation shall be deducted from the dividend.

It is perhaps a question whether under these conditions income which consists of dividends should be considered as subject to the normal tax or as exempt. It may be contended that a tax upon the net earnings

of corporations is virtually a tax on the stockholder's income, and in theory this is true. But so long as the tax is not actually withheld from the dividends, or the dividends are not reduced in consequence of the tax, the stockholder's current income is not affected. The imposition of the tax might indeed affect his prospective income and might depreciate the value of his stocks. It is hardly likely, however, that such effects will be perceptible, at least as regards the stocks of railroads and other large corporations. If, however, it be considered that income consisting of dividends pays the tax, it follows that the stockholder's income is taxed no matter how small it may be. No minimum is left exempt. On the other hand, if it be considered that all dividends are virtually exempt, the stockholder would seem to be unduly favored under this form of taxation in comparison with people whose incomes are derived from other sources. Doubtless in future the investor will look upon dividends as a form of income not subject to the normal income tax.

## II

In the levy of the normal income tax there is to be a limited application of the method of assessment and collection at the source of the income. This method is applied very completely in the taxation of income in Great Britain. It may be well to recall summarily the essential features of the British system. The tax is levied upon the property or industrial enterprise which yields or produces the income. But the person occupying the property or conducting the enterprise, and paying the assessment in the first instance, is authorized and required to deduct the tax from the income as it is distributed among the persons entitled to share in it either as proprietors, landlords, creditors, or employees.

Under the English system, an industrial corporation, for instance, pays the income tax upon its gross earnings and then deducts it from the dividends, interest, salaries, and rents as these payments are made. The householder pays an assessment levied upon the annual value of his dwelling (less an allowance for repairs and insurance) and then if he occupies the premises as tenant deducts the tax from his rent. The income from agriculture is reached by a similar assessment upon the farmer, based upon the annual or rental value of the farm and with the same right of deduction from the rent if he is a tenant farmer.

From the standpoint of the government, the main advantage of this mode of assessment as compared with a tax levied directly upon the recipients of the income is the greater certainty with which it reaches the income subject to taxation. The opportunities for evasion by concealment of income are reduced to a minimum, partly because the sources of income are, in general, not easily concealed and partly because, to a considerable extent, the persons upon whom the tax is assessed are not interested in avoiding the tax. The advantages, however, are not all on the side of the government. The tax possesses certain advantages from the standpoint of the tax-payer also, assuming him to be an honest tax-payer who is not seeking opportunities to evade taxation. One advantage is that he is relieved in almost every case from the necessity of revealing to the tax officials the whole of his personal income. The tax does not pry into his personal affairs. Another advantage is that the tax is paid out of current income, being deducted from the income as it is received. It is therefore distributed over the year and adjusted to the flow of income as it comes in. A tax thus collected is less burdensome in its incidence than a tax paid in

one lump sum several months after the expiration of the year to which it relates and after the income on which it is levied has been all received and perhaps all expended.

The English system of assessing an income tax at the source, however, has its disadvantages. It is admirably suited for a tax levied at a uniform rate on all income or on all income above a small minimum. But it is not well suited for the application of progressive taxation or for the introduction of gradations or distinctions based upon the size or character of the individual incomes. Nevertheless the English income tax, besides exempting a minimum, provides for graded reductions or abatements in favor of the possessors of small incomes above the minimum, and for a reduced rate on "unearned" income within certain limits. All this, however, makes necessary a declaration or complete statement of income from the persons claiming the benefit of these provisions, and also necessitates refunding a large amount of the tax collected at the source. Moreover the progressive principle has recently been applied by imposing a "super-tax" on incomes in excess of £5,000, which also requires a declaration, the tax being necessarily assessed upon the possessor of the income and not at the source. The super-tax, it may be observed, occupies a position in the English system similar to that of the additional tax in the United States, serving to increase the tax upon the larger incomes in accordance with the principle of progression.

It has been stated above that the law which has just been enacted by Congress makes a limited application of this principle of assessment at the source, as regards the normal tax. The general rule of the law covering deduction at the source is of sufficient importance to be quoted in full. It reads as follows: —

All persons, firms, co-partnerships, companies, corporations, joint-stock companies or associations, and insurance companies, in whatever capacity acting, including lessees or mortgagors of real or personal property, trustees acting in any trust capacity, executors, administrators, agents, receivers, conservators, employers, and all officers and employees of the United States having the control, receipt, custody, disposal, or payment of interest, rent, salaries, wages, premiums, annuities, compensations, remuneration, emoluments or other fixed or determinable annual gains, profits, and income of another person, exceeding $3,000 for any taxable year, other than dividends on capital stock, or from the net earnings of corporations and joint-stock companies or associations subject to like tax, who are required to make and render a return in behalf of another,[1] as provided herein, to the collector of his, her or its district, are hereby authorized and required to deduct and withhold from such annual gains, profits, and income such sum as will be sufficient to pay the normal tax imposed thereon by this section, and shall pay to the officer of the United States Government authorized to receive the same; and they are each hereby made personally liable for such tax.

Under this paragraph of the act every person, corporation, etc., making payments of more than $3,000 in interest, rent, salary, etc., to any one person in any one year must in each instance deduct the normal tax and pay it to the tax collector. It should be noted, however, that the rule covers not only "payments" but also the "control, receipt, custody, or disposal" of such sums. It is impossible to say just what may be comprised under these terms. But the word "payment" doubtless represents the typical or usual case, and in the discussion which follows will be used in a generic sense to cover all cases.

The limitation of the operation of the above paragraph to payments in excess of $3,000 was presumably deemed necessary, or at least advisable, because income

[1] This restrictive clause appears to have very little significance, for the reason that the persons, firms, etc., "who are required to make and render a return in behalf of another" are apparently the persons, firms, etc., just enumerated, namely, those having the control, receipt, custody, etc., of the annual gains, profits, and income of another person, exceeding $3,000. The paragraph which defines the persons, firms, etc., who are to make returns in behalf of another person is cited on p. 64.

up to that limit is exempt. The intention seems to be, however, that when the normal tax is deducted it shall be computed on the total payment and not simply on the excess over $3,000. That being the case it is evident that the deduction of the tax under this rule, tho limited to sums of more than $3,000, will nevertheless reach a certain amount of income which is exempt. It will do this where the entire income of any person is derived from a single source or from several sources each of which yields more than $3,000. On the other hand, it is evident that a large proportion of the payments made in sums of less than $3,000 will represent taxable income, being received by persons whose incomes are above the limit of exemption. Many large incomes are derived wholly or in large part from sources which yield less than $3,000 each. The adoption of a $3,000 limit for the application of the method of deduction at the source therefore appears to be a compromise, a half-way measure. It comes far short of reaching at the source all income subject to taxation, and at the same time seems likely to reach some income that is exempt. This does not necessarily mean that any taxable income will escape assessment or that any tax-payer will lose the benefit of the exemption. Income not reached at the source is to be included in the taxable income of the person who receives it; and the tax-payer's right to exemption is safe-guarded by special provisions which are discussed below.

This $3,000 limit, however, and the general rule of the law as regards deducting the tax at the source are materially modified by the exceptions or provisos. It is to be noted, in the first place, that in the paragraph just cited, dividends are altogether excepted from the classes of payments which are subject to the deduction of the tax. The exception applies only to dividends

paid by corporations "subject to like tax," but these include practically all corporations either located or doing business in the United States. The source of this income is supposed to have been reached by the tax on the earnings of the corporations.

Again, the application of the method of collecting the tax by deduction is very materially affected, and in quite a different way, by a proviso which removes the $3,000 limit as regards interest payments made by corporations. The normal tax is to be deducted and withheld from the "interest upon bonds and mortgages, or deeds of trust or other similar obligations of corporations, joint-stock companies or associations, and insurance companies, whether payable annually or at shorter or longer periods, altho such interest does not amount to $3,000." A large proportion of the bonds issued by corporations, however, guarantee the payment of interest without deduction on account of taxes. In such cases the corporations will undoubtedly assume the burden of the tax, as the provisions of the law just cited are hardly likely to be construed as requiring the violation of contracts. At one stage in the preparation of the law, a clause was inserted providing that the interest in such cases as this should be included in the taxable income of the bondholder and assessed to him. This clause, however, was not retained in the act as passed. But a proviso was inserted that no "contract entered into after this act takes effect" shall be "valid in regard to any Federal income tax imposed upon a person liable to such payment"; it is intended to prohibit any future issue of bonds guaranteeing exemption from the income tax.

Considering the various provisos and exceptions in connection with the general rule of the act, the scope of the application of the method of collecting the tax

at the source may perhaps be safely stated thus: the normal tax is to be deducted (1) from all interest payments made by corporations on bonds and the like, without regard to the amount; (2) from all other interest payments when the amount is more than $3,000 in any one year; (3) from all payments of rents, salaries, or wages amounting in any one case to over $3,000 annually; (4) from all other payments of over $3,000 (excepting dividends) which may be comprised under the designations "premiums, compensations, remuneration, emoluments, or other fixed or determinable gains, profits, or income."

One general restriction upon the application of the method of deducting the tax at the source should perhaps be mentioned. It is indicated by the words "fixed and determinable." That these words are not unimportant would seem to be indicated by their recurrence in other connections, and particularly by a proviso in the paragraph defining the deductions which may be made in computing taxable income. This proviso reads:

> Provided that whenever the tax upon the income of a person is required to be withheld and paid at the source as hereinafter required, if such annual income does not exceed the sum of $3,000 or is not fixed or certain, or is indefinite, or irregular as to amount or time of accrual, the same shall not be deducted in the personal return of such person.

This proviso emphasizes the fact that there are at least two general conditions to be met before deduction at the source is required: first, as already explained, the amount of income paid out must (with exceptions already noted) exceed $3,000; and second, it must be fixed, certain, definite, and regular. Strictly speaking there would seem to be very little income which is fixed and certain in advance of its actual receipt and very little which is not fixed and certain after it has

been received. Doubtless, the terms here used are intended to cover periodical payments of income, such as salaries or interest, made in fixed or stipulated amounts. But even as regards such payments there is usually no certainty in any given instance that they will continue to be made to the same person throughout the year. Interest bearing notes and mortgages are usually transferable, and salaried positions are not always permanent. It will often not be possible to say in advance whether the aggregate payments will amount to $3,000. Instructions already issued by the Treasury Department provide that no tax shall be withheld until the accumulated payments of the current year pass the $3,000 limit, and that the person making these payments shall thereafter deduct the tax, the first deduction covering the tax on all payments up to date. But simple as such a procedure may be in theory, in the complicated and shifting relationships of the business world it will not always be easy to follow. The *payer* of income as well as the *payee* may change, and change more than once, during the same calendar year.

Income from investments in foreign countries is, of course, derived from sources which are inaccessible to this government. The law, however, undertakes to intercept the tax on certain classes of income of foreign origin by providing that the normal tax "shall be deducted and withheld from coupons, checks, or bills of exchange for or in payment of interest upon bonds of foreign countries and upon foreign mortgages or like obligations (not payable in the United States), and also from coupons, checks, or bills of exchange for or in payment of any dividends upon the stock or interest upon the obligations of foreign corporations, associations, and insurance companies engaged in

business in foreign countries." This deduction of the tax is to be made by " any banker or person who shall sell or otherwise realize coupons, checks, or bills of exchange drawn or made in payment of any such interest or dividends (not payable in the United States), and any person who shall obtain payment (not in the United States), in behalf of another of such dividends and interest by means of coupons, checks, or bills of exchange, and also any dealer in such coupons who shall purchase the same for any such dividends or interest (not payable in the United States), otherwise than from a banker or another dealer in such coupons."

## III

In so far as the law requires the taxation of incomes at the source, some special provision must be made to ensure to the recipients of the incomes thus taxed the benefits of the minimum exemption and of any other deductions to which they may be lawfully entitled. The procedure to be followed is set forth in the following provisions of the law, the letters and numerals which mark subdivisions of the paragraph being inserted by the writer.

(1) In all cases where the income tax of a person is withheld and deducted and paid or to be paid at the source, as aforesaid, such person shall not receive the benefit of the deduction and exemption allowed in paragraph C of this section, except [redacted] by an application for refund of the tax unless he shall, [redacted] not less than thirty days prior to the day on which the return of his income is due, file with the person who is required to withhold and pay tax for him, a signed notice in writing claiming the benefit of such exemption and thereupon no tax shall be withheld upon the amount of such exemption; [redacted] nor shall any person under the foregoing conditions be allowed the benefit of any deduction provided for in subsection B of this section unless he shall, not less than thirty days prior to the day on which the return of his income is due, either [redacted] file with the person who is required to withhold and pay tax for him a true and correct

return of his annual gains, profits, and income from all other sources, and also the deductions asked for, and the showing thus made shall then become a part of the return to be made in his behalf by the person required to withhold and pay the tax, or may likewise make application for deductions to the collector of the district in which return is made or to be made for him.

The first part of this paragraph prescribes the steps which must be taken in order to secure the benefits of the general exemption of $3,000 or, in case of a married man, of $4,000. The second part relates to the deductions on account of business expenses, interest on indebtedness, taxes, losses, dividends and the like, which, as set forth in subsection B of the act, are permitted in computing the net income subject to taxation. The procedure to be followed does not seem to differ essentially in the two cases. The initiative rests with the tax-payer, or person from whose income the tax will, in absence of any action on his part, be deducted at the source. The law apparently gives the tax-payer the option of two alternatives — either to forestall the deduction of the tax or to secure a refund of the tax after it has been collected. The right to have the tax refunded in order to secure the benefits of the minimum exemption is clearly implied by the clause, "except by an application for the refund of the tax," appearing in the first part of the paragraph. That the deductions allowable on account of expenses and interest may likewise be obtained by a refund of the tax collected at the source is indicated by the clause at the end of the paragraph giving the tax-payer the option of making "application for deductions to the collector of the district in which return is made or to be made for him."

If the tax-payer prefers to forestall the deduction of the tax, the procedure prescribed by the law as applied to exemptions and as applied to deductions of income on account of expenses differs in one particular. As

regards the exemption all that he need do is "to file with the person who is required to withhold and pay the tax for him, a written notice claiming the benefit of such exemption." But if he wishes to forestall the retention of the tax on any income which is not taxable because it is offset by allowable deductions, he must file "a true and correct return of his annual gains, profits, and income from all other sources and also the deductions asked for." This return likewise is to be filed with the person "required to withhold and pay the tax." It would seem hardly possible, however, to make such a return prior to the completion of the calendar year for which the income is to be computed; and therefore it is difficult to see how the tax-payer can exercise this right in such a way as actually to forestall the retention of the tax at the source, unless the tax officials construe the law as permitting the acceptance of a statement of prospective income filed in advance of the actual receipt of the income. It may be noted in this connection, however, that the person retaining the tax at the source apparently is not required to pay it over to the government until the expiration of six months after the completion of the year for which the tax was assessed.[1] It is conceivable, therefore, that the tax-payer, instead of attempting to forestall the retention of the tax, might file his claim and return of income after the close of the tax year, not with the tax collector but with the person withholding the tax, so as to obtain a refund of it before it has been paid over to the tax collector. This possibility is suggested by the provision as to the period within which the claim

[1] As to time of payment there is no provision in the law except the general provision that all assessments shall be paid on or before the 30th of June. This would seem to cover assessments at the source, in view of the fact that the special provision requiring deduction of the tax simply states that the person withholding the tax shall pay it to officers of the government authorized to receive it, without specifying when it shall be paid.

may be filed, namely, " not less than thirty days before the day on which his return of income is due." The " return of income " is due on March 1st and therefore the claim may be filed at any time prior to the 29th or perhaps 30th of January following the year in which the income accrues.

No similar difficulty stands in the way of forestalling the retention of the tax when it concerns the exemption of a minimum. Here, as previously explained, the tax-payer's application need not be accompanied by a statement of income, presumably because this exemption is not dependent upon the amount of his income. He is entitled to the relief whatever his income may be. It would seem, therefore, entirely practicable in most cases to forestall the retention of the tax at the source where it affects the tax-payer's right to exemption.

The claim to exemption or deduction, with the accompanying return of income, when filed with the person who would otherwise retain the tax, is to be submitted by the latter, in making his own returns to the tax collector as his authorization for not having collected or retained the tax. This appears to be the meaning of the provision that " the showing thus made shall then become a part of the return to be made in his [the claimant's] behalf by the person required to withhold and pay the tax."

## IV

The principle of assessing income at its source as applied in this act does not relieve the individual from the necessity of making a full revelation to the tax officials of his personal income from all sources. Tho this statement needs to be qualified in one or two particulars, the law provides in general that every person subject to the tax and having an income of

$3,000 or over shall make a true and accurate return under oath or affirmation "setting forth specifically the gross amount of income from all separate sources and from the total thereof deducting the aggregate items or expenses and allowance" authorized by the law. Altho income from which the tax has been withheld is not included in the net personal and taxable income of the tax-payer, it must, nevertheless, be accounted for and included in his declaration as a part of his gross income, forming one of the specified items which are to be deducted from the gross income in arriving at the income subject to taxation.

As already intimated, the general requirement of the full and complete statement of income is subject to certain exceptions. One relates to the income from dividends, the law providing that "persons liable to the normal tax only . . . shall not be required to make return of the income derived from dividends on the capital stock or from the net earnings of corporations, joint-stock companies or associations, and insurance companies taxable upon their net income." It will be noted that this proviso is restricted to persons who are "liable for the normal tax only," *i. e.*, persons having net incomes under $20,000. It would seem, therefore, that the tax-payer claiming and securing this privilege must in some way, without revealing the amount received from dividends, satisfy the tax assessors that his total net income including the dividends (amount not stated) does not exceed $20,000. Of course a form of statement can easily be devised to cover the situation. But whether the law will be administered in such a way that this provision affords some relief from the general obligation of making a detailed and complete statement of income remains to be seen.

Another exception to the general requirement of a complete declaration of income covers the case of the tax-payer whose entire income has been assessed and the tax on it deducted at the source. The law relieves such persons from the obligation of making any declaration of income; altho it is not certain that this privilege can be secured without foregoing or sacrificing the benefits of any abatements to which the individual tax-payer might be entitled on account of business expenses, interest payments, losses, etc. It seems probable that where the income is all assessed at the source the tax-payer may obtain the benefit of the minimum exemption without making a declaration of income.

It appears, therefore, that assessment at the source does not, under this law, operate in such a way as to afford the tax-payer any substantial relief from the necessity of making a revelation of his income to tax officials. Whatever basis there may be for the common criticism or complaint that an income tax is inquisitorial remains under the operation of this law to nearly the same extent that it would if the tax were levied wholly and directly upon the recipients of the income, with no resort to taxation at the source.

In addition to the returns which the individual is required to make covering his own income, every individual, firm, or corporation is required to make a return covering payments on which the tax has been deducted and giving the name and address, if known, of the persons to whom such payments were made. As regards the scope and application of this requirement, the law is not altogether clear or explicit. It seems best, therefore, to cite again the exact language of the statute:

> All persons, firms, companies, co-partnerships, corporations, joint-stock companies or associations, and insurance companies, except as hereinafter provided, in whatever capacity acting, having the control, receipt, disposal, or payment of fixed or determinable annual or periodical gains, profits, and income of another person, subject to tax, shall in behalf of such person deduct and withhold from the payment an amount equivalent to the normal income tax upon the same and make and render a return, as aforesaid, but separate and distinct, of the portion of the income of each person from which the normal tax has been thus withheld, and containing also the name and address of such person or stating that the name and address or the address, as the case may be, are unknown: . . . *Provided*, That . . . no return of income not exceeding $3,000 shall be required.

The introduction of the last proviso (that no return should be made of payments of income not exceeding $3,000) was probably thought necessary in order to be consistent with the general rule that the tax shall be withheld and deducted only from payments exceeding that amount; but to that general rule there is one important exception, as already noted, covering interest payments made by corporations. The tax on such payments is to be deducted in all cases without regard to the amounts. There is no corresponding exception to the rule as to returns. The language of the statute, strictly interpreted, would seem to mean that the corporations, altho required to deduct the tax from all payments of interest, are not required to make a return of the names and addresses of persons to whom annual interest payments are made in amounts not exceeding $3,000.

It is, in fact, hardly possible in advance of the official interpretation and actual enforcement of the law to say how far this requirement of a return of payments of income taxed at the source extends or to whom it will apply. But as regards the deduction of the tax and the returns to be made in connection with the pay-

ment of the interest on corporation bonds, Treasury regulations have already been published, indicating the procedure to be followed. The case of registered bonds presents no especial difficulty, the officers of the corporation being in a position to make the required return giving the name of the bondholder and the amount of interest paid to him. But the procedure that would be followed in connection with the large amount of interest paid out on coupon bonds was not so obvious. In this case the corporation issuing the bonds and ultimately paying the interest has, as a rule, no knowledge who the bondholders are or how much interest they individually receive. The only person who can give this information is the person who cashes the coupons for the bondholder in the first instance. Usually coupons are redeemed through the banks; and the Treasury regulations above referred to provide that the coupons when presented to banks or other agencies for redemption or collection must be accompanied by a certificate of ownership signed by the owner of the bonds. In this case, presumably, the bank will collect from the corporation the interest less the tax and the corporation will pay the tax to the government. The failure to supply such a certificate places upon the bank accepting the coupons the obligation of retaining the tax and, at the same time, attaching to the coupons its own certificate giving the name and address of the owner of the coupons or of the person presenting them. Here the intention seems to be that the bank shall deduct and withhold the tax, collect the interest in full from the corporation, and ultimately pay the tax to the government. The corporations are to deliver all certificates to the tax collector on or before the 20th of the month following that in which they were received.

## V

Regarding the assessment of the additional tax not much need be said in the way of explanation. It is, in theory at least, a comparatively simple matter. There is no attempt here to make any application of the principle of collection at the source. The tax is all levied directly upon the recipients of the individual incomes and the assessment is based upon the tax-payer's declaration, which for the purposes of this tax must cover the "entire net income from all sources, corporate or otherwise." The tax is thus largely distinct from the normal income tax as regards both the method of assessment and the rates. It is, however, to be administered through the same machinery, and no doubt to some extent the information obtained as to the sources of income in connection with the assessment of the normal tax will prove useful as a check upon the returns of income required for assessment of the additional tax. Every person whose income exceeds $20,000 will be subject to both taxes, the normal and the additional, but presumably will be required to make only one declaration. For the purposes of the additional tax he will be required to declare his income from all sources, and therefore any relief from the obligation of making a complete revelation of income which may be secured to him through the application of the principle of assessment at the source in connection with the normal tax will be entirely sacrificed.

## VI

The administration of a direct personal income tax — using that term to describe a tax levied directly on individual incomes — is a comparatively simple matter, however ineffective it may prove to be in reaching the

income subject to it. Under this method of taxation it is easy to exempt a minimum, to apply progression in the rates, or to make any other adjustments that may be deemed equitable with reference either to the size or character of the income or to the circumstances of the tax-payer. But as soon as we depart from this simple method and resort to taxation at the source, we encounter difficulties in varying the rates, allowing exemptions, or making any similar adjustments. In the English income tax, these difficulties are squarely met and surmounted. As previously explained, that tax is in the first instance levied indiscriminately on all accessible sources of income and the adjustments are effected by refunding the tax collected at the source so far as may be necessary. No provision is made for forestalling the deduction of the tax, and no returns are required of the names and addresses of persons to whom payments of income are made. The exemption, however, is small ($800) and the abatements extend only to incomes below $3,500. Above that point the entire income is taxable.

A tax which provides for the exemption of $3,000 or $4,000 from every individual income places a formidable barrier in the way of a thoro-going application of assessment at the source. It is evident that with a universal exemption as high as this, a very large amount of tax withheld and collected at the source would ultimately have to be refunded. The law as enacted indicates an intention to secure in part the advantage of assessment at the source and at the same time avoid in part the attendant disadvantage of having to refund the tax. The measure might be characterized as one which as regards the "normal tax" applies the principle of assessment at the source to corporate income completely and to other income in spots. The "addi-

tional tax" is simply the direct personal tax. The normal tax will doubtless be successful in reaching the large amount of income earned or created by enterprises conducted under the corporate form of organization, much of which would probably escape assessment under a direct personal income tax. But beyond this it is questionable whether the method of assessment at the source as here applied will be of sufficient advantage to justify the administrative complications which it involves.

It seems useless, however, as well as unwise, to venture any predictions as to how successful the tax will be in reaching the income subject to it or how well it will work in actual practice. We can afford to wait and see. Much depends upon the way in which the law is administered. After it has been in operation for a year or two, after its novel features have been tested by actual experience and those provisions which are complicated or obscure have been interpreted by administrative rulings or possibly by court decisions, we shall have a better understanding of the merits or defects of the measure than is at present possible. The law will doubtless require amendment in many particulars even if it does not need to be radically revised. That the income tax in some form will be perpetuated as a permanent part of our system of national finance may safely be predicted. Properly adjusted and wisely administered it should greatly strengthen the financial resources of the government, make possible a closer adjustment of revenue to expenditure, and secure a more equitable distribution of the burden of taxation.

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WASHINGTON, D. C.

# FOUR YEARS MORE OF DEPOSIT GUARANTY

## SUMMARY

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IF the reader has visited Texas, Oklahoma, Kansas, or Nebraska within the past few years he has probably noticed on the windows of some of the banks the sign

"Deposits Guaranteed." If he has gone inside he has found the same advertisement on the stationery. Bank deposits in these states are protected by funds raised by special taxation of the banks and administered by the state banking boards. The system, established in Oklahoma as an outgrowth of the panic of 1907, and followed with variations in the three other states mentioned, has for its objects the distribution among bank stockholders generally, of losses that have heretofore fallen upon the depositors of failed banks, and as consequences, the prevention of individual distress, the prevention of panics by maintaining the confidence of depositors, and the increase, due to such confidence, of the volume of deposits and the usefulness of banks. This experiment, unparalleled, except for the New York episode of three-fourths of a century ago, was discussed by the present writer in these columns four years since.[1] The progress of the experiment since that time now warrants further conclusions, and it is proposed now to review the incidents of the intervening period.

At the time of the former study, the question of the validity of the Oklahoma, Kansas, and Nebraska deposit guaranty laws was pending in the Supreme Court of the United States. The Texas law had not been attacked, its opponents being willing, apparently, to abide by the results of litigation over the laws of the other commonwealths.

The three laws attacked were all upheld on the principle that such taxation was not the taking of private property for a private purpose, but was the taking of private property for a public purpose, and a valid exercise of the police power of the states. It was held that the state undoubtedly had the authority to lay

[1] Quarterly Journal of Economics, vol. xxiv, pp. 85, 327; reprinted in Sen. Doc., No. 659, 61st Cong., 3d Session, Appendix B.

down such conditions precedent to the conduct of the banking business. "In short," said the court, "when the Oklahoma legislature declares that free banking is a public danger, and that incorporation, inspection, and the above described co-operation [the provision of a guaranty fund by taxation] are necessary safe-guards, this court certainly cannot say that it is wrong." [1]

This litigation had been conducted with bitterness on both sides and its termination was a relief. While the legal problems were much the same in the various states, the financial and administrative questions have differed, and the experiences of the various states require separate consideration.

## I. Oklahoma

The first results of the guaranty legislation in Oklahoma had some appearance of success. The state banks gained rapidly in number and in business, while many national banks surrendered their charters and reorganized under the state law, the business of the remaining national banks keeping barely steady. For more than three years now the current has been the other way and the Oklahoma experiment is found to have cost the solvent state banks in five years more than two million dollars. Bank after bank has failed. Banks in large numbers have left the state system to enter the national system for the purpose of escaping the heavy assessments levied under the state law. The remaining state banks have now forced through a new law limiting more closely the annual assessments for the guaranty fund, and have been compelled to take

[1] Noble State Bank v. Haskell, 219 U. S., 104, 31 Supreme Court Reporter, 186; Shallenberger v. First State Bank, 219 U. S. 114, 31 Supreme Court Reporter, 189; Assaria State Bank v. Dolley, 219 U. S. 121, 31 Supreme Court Reporter, 189; Abilene National Bank v. Dolley, 33 Supreme Court Reporter No. 10, p. 409.

matters, as far as possible, into their own hands. Such a result was forecasted in the articles in this Journal three and four years ago.

The Oklahoma laws of 1907 and 1909 provided for the accumulation of a guaranty fund of five per cent of the deposits of the state banks, out of which the depositors of failed banks should be paid the amount of their deposits as soon as banks closed, no matter whether the fund had reached the five per cent maximum or not. In case the accumulations in the fund should ever be insufficient to pay the deposits of any failed bank, interest bearing warrants were to be issued to the depositors. The conclusion from a study of the situation in 1909 was that any plan that provided for payment of depositors immediately upon the closing of the banks must fail, unless as a matter of simple luck failures should be very few until a large fund could be accumulated.[1] The luck has been the other way. The Oklahoma crops of 1910 and 1911 were poor. The crops of 1912, tho on the whole good, were not sufficient to restore the former level of prosperity. The year 1913, except in the cotton raising counties, has been unfavorable. The real estate boom that had been going on in many Oklahoma towns collapsed in 1910 and the succeeding years. Since the date of our former study, therefore, the state of Oklahoma has not enjoyed even average prosperity for the working out of the experiment of deposit guaranty.

No fewer than twenty-seven banks, with about $7,000,000 of deposits, have failed since the establishment of the guaranty system, or have been liquidated with the aid of the guaranty fund, and at least two others have required assistance from the guaranty fund. These failures, however, cannot be attributed to the

[1] Quarterly Journal of Economics, vol. xxiv, p. 340.

adverse agricultural conditions. Only three national banks have failed in Oklahoma during the same time. Many of the state bank failures must be due to recklessness and incompetence.

It will be remembered that the first guaranty law of Oklahoma was enacted immediately after the creation of that state, which includes what was formerly Oklahoma territory and also what was the Indian territory. The territory of Oklahoma had had a banking law and bank inspection while the Indian territory had not. It resulted that a great many banks that had never been supervised were thrown under the jurisdiction of the banking department of the state of Oklahoma. It was announced [1] that all were examined before the guaranty law went into effect, but this proves not to have been literally true. Results indicate also that the examinations were in many cases superficial and inefficient. The report of the Bank Commissioner about that time states that a large number of banks were technically not in harmony with every provision of the laws.[2] It was, however, felt by the state authorities that it would be unwise, and certainly it would have been unpopular, to put these banks out of business. Their deposits were, therefore, guaranteed and they remained a menace to the guaranty experiment. It is now said in Oklahoma that 75 of them were actually insolvent. This assertion cannot, of course, be verified; it illustrates the bad feeling caused by losses and consequent heavy assessments upon the solvent banks.

Perhaps the most unfortunate condition of all has been that for much of the time the state banking department was regarded as a part of a political machine. The department seems to have considered it necessary

[1] First Annual Report of the Bank Commissioner, p. viii.

[2] Ibid., p. ix.

to make a showing of success for the guaranty law, which was a political measure. When it was no longer possible to keep a bank open it was deemed essential to pay the depositors at once even if prudence would have dictated that time be taken for exact investigation of the situation. At the same time the Banking Board feared the political effect of levying on the solvent banks assessments sufficient to cover all failures as they occurred. It was believed, and was probably true that, if the limit of assessments, two per cent of deposits per annum, should be levied, the state banks would literally rebel. While the courts would undoubtedly have decided that the banks must pay the full assessments, in practice such assessments could not have been enforced. If the six hundred state banks had combined to resist such assessments, court decrees would not have amounted to much and the political prestige of Governor Haskell and his Bank Commissioners would have suffered irreparable injury.

Again, there have been more than a few cases of outright dishonesty in the administration of the banks. The present Bank Commissioner of Oklahoma has said that the heaviest losses of the past few years could have been avoided if more careful scrutiny had been given to the records of those who sought permission to organize and operate banks.[1] In a recent conversation this Commissioner, Mr. Lankford, told the writer that he had removed twenty bank officers and prosecuted sixteen others during his term.

Some rascals come into every new country and every new state at its settlement. That there have been bad men in Oklahoma banks will not surprise those who remember how Oklahoma was first settled by horsemen who lined up at the Kansas or the Texas

[1] Proceedings of the Oklahoma Bankers' Association, 1912, p. 91.

border and at a signal rode for the choice claims, nor those who remember that for years the Indian territory had not even a territorial government, justice being administered by the Indian tribes or by infrequent federal process. Good men predominated, of course. The wonder is that bad men have been so few and are being got rid of so fast.

Now a record of nearly thirty bank failures in five years, with almost all of them coming in three years, has not been equalled in the United States for a long time, the most recent parallel being perhaps the experience of some western states during and after the panic of 1893. The comparison holds good with respect to some of the Oklahoma failures. The greater number were simply a result of collapse after rapid settlement and exploitation, followed by a period of agricultural adversity, in a state where the records and the capacity of bankers were not closely investigated, and where bank examinations were in too many cases ineffective. These are not the cases, however, that have cost the guaranty fund any great part of the two million dollar loss.

It will be instructive to consider certain failures and see how they affected the guaranty fund, or have been affected by it. In November, 1910, the Creek Bank & Trust Company of Sapulpa failed. This was a crooked failure and one of the officers was sentenced to the penitentiary. September 10, 1912, there was another failure at Sapulpa, the Farmers and Merchants Bank, which one of the State Banking Board told the writer was the worst mass of filth he had seen in Oklahoma banking. Two of the officers were in jail for some time for failing to produce some of the books.

The Citizens Bank of Mountain Park failed in April, 1911. The last report of the Bank Commissioner says

that twenty-five thousand dollars of the notes held by the failed bank represented fraudulent transactions of the officers, who had been arrested and were then under bond awaiting trial.[1]

The Bank Commissioner took charge of the Night and Day Bank of Oklahoma City, June 7, 1911. This was one of a chain of Night and Day Banks operating in Memphis, Tennessee, Kansas City, Missouri, and Little Rock, Arkansas. Another bank in Hot Springs was also in the chain. Abner Davis, President of the Oklahoma City institution, was convicted in the United States Court at Memphis, in October, 1912, with five others, for misuse of the mails in the furtherance of fraudulent bank schemes. He went to old Mexico, and there was a rumor that he was thrown into jail there for some other reason. The following amusing incident is here set down for any bearing it may have on the quality of some Oklahoma examinations a few years ago. A banker who was then a state bank examiner in Missouri tells the writer that he was in Oklahoma City to gather some information bearing on the Kansas City institution, and that one of the Oklahoma examiners was assisting him by looking over the books of the affiliated Oklahoma City bank. The Oklahoma City examiner came back to the hotel and told the Missouri examiner that everything must be all right, that Abner Davis had $30,000 on deposit in the Night and Day Bank of Oklahoma City. The Missouri examiner told him he had better go back and look again and make a thoro investigation of that account. The Oklahoma examiner insisted, however, that he was correct. When the bank closed a short time later it developed that the $30,000 was not a credit, but was an overdraft, and that the

[1] Third Biennial Report of Bank Commissioner, p. xiv.

examiner had been deceived because the amount had been carried on the books in black ink instead of red.

This bank finally cost the guaranty fund about $400,000. The efforts of the Banking Board to save the bank by guaranteeing its assets to successive purchasers are told below.

The Farmers State Bank of Tushka was closed in September of the same year. It cost the Fund $26,000 and the cashier committed suicide as soon as the State Bank Examiner took charge.[1]

The First State Bank of Pryor lost its capital of $30,000 and $30,000 besides, but the stockholders made good the loss to depositors. This failure, therefore, cost the guaranty fund nothing.

The administration of the banking department during this time of numerous bank failures has been, of course, a matter of extreme difficulty. The law contemplated, and politics demanded, that the depositors be taken care of at once. Yet with failure after failure coming, and with the banks rebelling against the intolerable assessments, it seemed necessary to resort to most astonishing expedients. The provision of the law applicable was the following:

"If the amount realized from such emergency assessments shall be insufficient to pay off the depositors of all failed banks having valid claims against said depositors' guaranty fund, the State Banking Board shall issue and deliver *to each depositor* having any such unpaid deposit, a certificate of indebtedness for the amount of his unpaid deposit, bearing six per cent interest." [2]

Instead of closing insolvent banks, however, and issuing such warrants to depositors, the State Banking

[1] Ibid., p. xviii.

[2] Banking and Trust Company laws of Oklahoma, effective June 11, 1909, Art. II, Sec. 2. Italics are the writer's.

Board resorted to all kinds of schemes to keep the insolvent banks running, hoping against hope that they might be restored to solvency or that actual collapse might be avoided until the fund could be replenished sufficiently to take care of the depositors. For these reasons the Board borrowed money in Oklahoma and elsewhere, issuing warrants therefor against the guaranty fund. In the opinion of the writer authority for such warrants existed nowhere in the law either specially or by implication. Further, the Board has bought securities from banks in a critical condition in order to provide such banks with cash; has made deposits in other failing banks; and has frequently induced one bank to take over the business of an insolvent bank by guaranteeing to the solvent bank the assets of the insolvent bank. Such efforts to postpone the evil day do not often succeed. They are far more apt to be a throwing of good money after bad, and such procedure has been bitterly criticised by the solvent state banks, who believe that their assessments to meet failures have been greatly increased by the temporizing policy of the Banking Board.[1]

The first great test of the Oklahoma guaranty law, it will be remembered, came with the failure of the Columbia Bank & Trust Company of Oklahoma City late in 1909. That still remains the greatest failure that has occurred in Oklahoma banking, both from the point of view of the amount of deposits involved and from the point of view of loss to the guaranty fund.

In the former study of the guaranty of bank deposits it seemed necessary to criticise the procedure of the Oklahoma Banking Department in beginning to pay depositors without any adequate inquiry into the extent of the failure. It now appears that the department

[1] Proceedings of the Oklahoma Bankers' Association, 1912, p. 77.

was even more reckless than was then supposed, and that it did not even first prove the amount of notes and securities on hand, much less their value. The result was that when an attempt was made to take a proof some three days after the failure there was a discrepancy between the books and the notes of more than $70,000. It proved impossible to locate the discrepancy, because essential records, including the discount ledger and general cash journal, had absolutely disappeared. So far as the writer is aware they have never been discovered.

A sale of certain securities to Cobe and McKinnon of Chicago was arranged for the sum of $300,000 and up to January 30, 1911, $248,000 had been received from Cobe and McKinnon by the Banking Board. Cobe and McKinnon, however, were at that time claiming large sums from the Banking Board on account of the failure of title to certain items which they had included in their bid. On the other hand, the cost to the Banking Board of releasing from liens and from possible bankruptcy proceedings such notes and securities as it had actually delivered to Cobe and McKinnon had been $194,000, or within $54,000 of the whole amount the Board had received.[1] The writer is informed that litigation over the claims of Cobe and McKinnon is still pending. This one failure has cost the Oklahoma banks $600,000. Almost worse than the actual loss have been the suspicions and recriminations aroused by the incidents of the failure and the liquidation.

In January, 1911, the Banking Board made a sale of 460 shares of stock of the Night and Day Bank of Oklahoma City to C. J. Webster and his associates with the agreement that the $46,000 paid in by Webster should be considered an asset of the bank, which, with

[1] Report on Oklahoma State Guaranty Fund by Arthur Young and Co., p. 73.

surplus and profits, should be kept in a separate account known as an "indemnity account," to be used from time to time to indemnify C. J. Webster and his associates against any loss of any kind whatever due to impairment of capital or insufficiency or insolvency of notes or other securities or against any discrepancy in the accounts. The sum of $60,000 was left on deposit by the Banking Board as additional security to Mr. Webster, and the bank was kept running. Later the bank was taken over by the Wilkin-Hale State Bank of Oklahoma City, the Banking Board taking all doubtful assets not accepted by the Wilkin-Hale State Bank and paying the latter the difference between the liabilities assumed and the assets taken. This difference was paid largely in warrants which were themselves only paid this year. The cost to the Banking Board in liquidating the Night and Day Bank had been, to January 1, 1913, $366,000.[1]

The Planters and Mechanics Bank of Oklahoma City was allowed to run long after its desperate condition was known. This was one bank from which the Banking Board purchased certain securities in an effort to keep it going. As early as July, 1910, the Banking Board was depositing money in it, and was buying securities from it, in an effort to strengthen its reserve.[2] The bank was not closed, however, until April 6, 1911. Bankers expect the failure to cost the guaranty fund about $300,000.

At Durant, the Banking Board deposited $25,000 in the Guaranty State Bank as security against any loss it might sustain in liquidating the Oklahoma State Bank.

[1] Third Biennial Report of the Bank Commissioner, p. xv.

[2] Report on Oklahoma State Guaranty Fund by Arthur Young and Co., p. 77.

At Muskogee, the Alamo State Bank took over certain assets of the Oklahoma Trust Company, and assumed certain liabilities. Later it was reported that the Alamo State Bank was itself not in a condition to continue business without additional capital. The Union State Bank was therefore organized to take over the business and to it the State Banking Board paid $40,000 as a part of its capital, the Board holding the shares as security for its advances.[1] The load has proved too heavy for the Union State Bank and it has just been closed (September 13, 1913).

At Sapulpa and Ochlelata new banks were organized to assume the deposit liabilities of failed banks, under guaranty of assets by the State Banking Board. At Oklahoma City in a recent case the Banking Board issued a large amount of warrants to enable a failing bank to continue in business under a new management. This case was in the mind of a banker who said in substance at the meeting of the State Bankers' Section of the Oklahoma Bankers' Association last May: "There will be a meeting of the Executive Committee after the close of this session. I want the state bank examiners who are present to remain for that meeting. I want them to explain how it is possible for a bank under their jurisdiction to fail for $140,000."

This bank illustrates some vicious tendencies of bank deposit guaranty unsupported by the strictest control of bank organizations. Its president was a man who years ago established a small bank in Oklahoma City and so failed to win the confidence of the community that he finally went out of business. Under the guaranty system he went into business again on a much larger scale. He obtained deposits of about $300,000, and

[1] Report on Oklahoma State Guaranty Fund, p. 91.

it has cost the Banking Board about $190,000, less salvage, to save the depositors.

Still another Oklahoma City case took $30,000 out of the guaranty fund. It is astonishing what a heavy proportion of all the losses has occurred at Oklahoma City. An Oklahoma City banker estimates the losses to the fund in his own city at $1,670,000 (the exact cost depends on the result of the liquidations). This may be high, but at any rate approximately three dollars out of every four the fund has lost have been lost in Oklahoma City, the metropolis and now the capital. The effect of unfavorable economic conditions has been cumulative upon those banks at the capital that from recklessness or inexperience have not been able to keep clear of bad paper, or in one case perhaps have not tried. It has been already pointed out that an inevitable effect of a state-administered system of deposit insurance, or guaranty, is that the state cannot limit the size of single risks. Nor can it avoid the "conflagration hazard" by fixing a maximum of risk that it will assume in a single locality.

The cases described sufficiently illustrate failures and liquidations. They are a sorrowful story, even tho not all failures were dishonest and not all liquidations wasteful. The procedure of the Banking Board in many cases where banks were in difficulty seems to the writer outside the law as it existed before the last session of the legislature. The law contemplated that the Banking Board should pay the depositors after failure, not that the Board should try to avert failure by depositing money in failing banks, buying their securities or guaranteeing their assets. How competent business men could do such incredible things can be explained in only one way. To repeat, these expedients were resorted to under the pressure

of real or supposed necessity, that of preventing the actual closing of the banks in such numbers as to break down the guaranty system. The writer was present this year at the meeting of the State Bankers' Section of the Oklahoma Bankers' Association. One of the new members of the State Banking Board nominated by the State Bankers themselves arose and said that he had formerly been of the opinion that the effort to keep insolvent institutions going was wrong, but that since becoming a member of the State Banking Board and having an opportunity to look at things from the inside he was not sure that there had been any other way. He was of the opinion, however, that it would be no longer necessary to postpone the closing of insolvent banks, because the new Oklahoma law adopted this year provides for smaller maximum assessments than before, and so seems to contemplate a condition wherein the issue of warrants to pay depositors of failed banks may be regarded as for the present the normal method of making such payment.

This brings us to a consideration of Oklahoma legislation since the article in this Journal three years ago. In 1911, there was an amendment of the guaranty act providing that trust companies should not have the benefit of the act and providing that the guaranty fund, when collected, should be deposited with the bank by which it was paid, and that a special certificate, or certificates, should be issued therefor to the Bank Commissioner, such certificates bearing interest at 4 per cent per annum. Changes made by the act of 1913 have been very important. The state banks had found intolerable a condition under which they had been assessed four and one-half per cent of their deposits in five years, and they told the politicians that if they would place

the State Banking Board in the hands of the bankers themselves, the bankers would serve without salary. The act, therefore, provides for the organization of the State Bankers' Association with one representative from each bank. This association nominates three persons from whom the Governor is to choose the Bank Commissioner and nine persons from whom the Governor is to select three other members of the Banking Board. The Commissioner and the three other members so selected are the Board. This is the first instance in America of conferring upon a Bankers' Association the power of making nominations for public offices.

The three members of the Banking Board selected by the Governor from the nominees of the Bankers' Association are John J. Gerlach, A. D. Kennedy, and W. F. Barber, all recognized as sound and experienced bankers.

Under the act of 1909, the Banking Board had authority to levy emergency assessments up to two per cent of the average daily deposits, but the Board had never dared to make emergency assessments exceeding one per cent. It is now provided that the regular assessments of one-fifth of one per cent of deposits shall not be exceeded except in the fiscal years 1914, 1915 and 1916, when the assessments may reach two-fifths of one per cent. Oklahoma State bankers are inclined to regard this as a great improvement in the law. It may be doubted, however, whether any law which diminishes the amount of taxation permissible for the replenishment of an insolvent fund can be regarded as an improvement. It is significant that the permanent guaranty fund to be accumulated is now reduced to two per cent of deposits instead of five, altho practically neither amount could be reached for years, if ever.

The new law follows the Nebraska law in not collecting the assessments until they are needed. Nebraska banks enter the amounts of the assessments on their books to the credit of the State Banking Board. Oklahoma banks pay with cashier's checks, not bearing interest, and the checks are to be held by the Banking Board till needed. It is not an element of strength in any insurance scheme to leave the collection of premiums until a loss occurs. One supposes that cashier's checks are taken instead of book credits in the belief that bankers objecting to assessments would pay their own cashier's checks, when they might possibly refuse to pay drafts by the Banking Board against a guaranty account set up on the bank's ledger. To secure its liabilities to the Depositors' Guaranty Fund, every state bank is now required to deposit with the Board bonds or warrants equal to one per cent of its deposits, but not less than $500 in any case. Some banks have refused to do this, but have not yet been closed for refusing.

Guaranty Fund Warrants can now legally be issued to any concern that will take them instead of merely to depositors of failed banks, as the law read before. That is, the Board can borrow money and so pay depositors in cash. State bankers, therefore, say that they have funded their debt. To make a market for the warrants, they are made legal security for public funds and for any deposits which foreign corporations are required to make in the office of the State Treasurer. Further, they are made non-taxable for any purpose whatever. Any bank may deduct its holdings of Depositors' Guaranty Fund Warrants when returning its capital for taxation. Such are the means employed to bolster up the paper of the guaranty system.

The criminal provisions of the banking laws were greatly strengthened because it had been found in practice almost impossible to obtain convictions for bank wrecking. Juries are sympathetic because, up to date, no depositor of a state bank has lost any money; and since no one in the community has lost anything the atmosphere is not favorable to the administration of punishment.[1]

These constantly recurring losses in Oklahoma City and elsewhere, aggregating $2,000,000, have made it necessary to assess the state banks an average of one per cent per annum on their deposits, a total of about $1,750,000. Yet the fund owed in June some $418,-926.56 of unpaid warrants with only $35,000 on hand.[2] Now one per cent of deposits is from four to seven per cent of the capital of the average Oklahoma state bank, depending on the season. Such a recurrent drain in lean crop years has become unendurable. To bring this home, the following table gives special instances told the writer, the names of the banks affected being, of course, omitted.

| | | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| In four years one bank with | | | $50,000 | capital | paid | $13,000 | in | assessments |
| " | " | " | 50,000 | " | " | 10,000 | " | " |
| " | " | " | 50,000 | " | " | 15,000 | " | " |
| " | " | " | 10,000 | " | " | 1,300 | " | " |
| " | " | " | 15,000 | " | " | 3,000 | " | " |
| " | " | " | 5,000 | " | " | 2,255 | " | " |
| " | " | " | 30,000 | " | " | 20,000 | " | " |

[1] "B. C. Burnett, 'Not Guilty,'"—"After a somewhat strenuous trial B. C. Burnett, one of the officers of the failed Sapulpa Bank, was declared not guilty. The bank was in bad shape about three years and was permitted to remain open by the banking board to reduce the Guaranty Fund liability, which was done. The verdict of the jury is in line with several other verdicts which established the belief that it is practically impossible to convict a banker on a loss to the Guaranty Fund. However, the Burnett case was not tried under the new law passed by the last legislature which is far more explicit and stringent than the old one." Oklahoma Banker, vol. IV, p. 370.

In Kansas the situation is very unlike this. There a banker accused of crime is thought to have very little chance with a jury.

[2] Letter from the Bank Commissioner.

The manager of the first bank in the table said to the writer: "That $13,000 would look good now, if I had it in my surplus account." The last bank in the table has since found it necessary or desirable to merge with another institution.

Many bankers have not been satisfied to wait under such crushing burdens for the enactment of legislation limiting the emergency assessments for the guaranty fund. From January 1, 1910, to April 21, 1913, 101 state banks in Oklahoma entered the National System. A few banks had already taken this step by the opening of 1910. Only 7 more followed in that year, altho the liquidation of the Columbia Bank and Trust Company and the emergency assessment levied in connection with that failure were bitterly resented. In January, 1911, the decisions in the guaranty cases were announced and in March, a further emergency assessment of one per cent was made. During 1911, therefore, no fewer than 65 banks nationalized. The movement continued all through 1912, when 21 banks left the state system. There has been no sign of a weakening of this tendency this year, 8 banks having nationalized up to April 21st.[1] Many thought to escape assessments already levied, but the courts hold that national banks are liable for assessments levied upon them before their nationalization and while they were yet state banks. It is announced that suits will be filed to collect such levies. These 101 banks have a total capital of more than $3,500,000, and the loss to the state system is very considerable. Besides the banks that have converted or reorganized, 10 banks, to the close of 1912, have consolidated with existing national banks. Twenty-eight of the 101 banks nationalized and 3 of the state banks that consolidated

[1] Letter from the Comptroller of the Currency.

with national banks had themselves been conversions from the national system. One of the most striking incidents of the early years of the Oklahoma experiment was the large number of banks that left the national system and entered the state system because of the increase in deposits that was observed to accrue to state banks. It is interesting to see how many of these and how many of the other state banks found the burden of guaranty assessments intolerable.

According to the reports of the Bank Commissioner, some 50 other state banks left the state system between January 1, 1910, and January 11, 1913, by liquidating or by consolidating with other state banks.

It must not be thought that all state banks have nationalized that could do so. The Bank Commissioner's report published last December shows 113 state banks with capitals of $25,000 or more, all of them, that is, large enough to enter the national system. Doubtless some of them were otherwise not in condition to nationalize, but many, or most of them, could have done so if their officers had believed the change advantageous. Of course the little banks with capital of $5000 to $20,000 cannot ordinarily nationalize without raising more capital than it is convenient for their stockholders to supply, or more than their business requires. Many banks remain in the state system, and many new state banks are organized, despite the guaranty taxes.

The reports of the Bank Commissioner show that from January 1, 1910, to November 26, 1912, 114 state banks were organized with $1,987,000 capital. New banks were organized at almost as rapid a rate during the first half of the present year. There is a craze to "start banks," and they are being organized in excess of economic need. The Bank Commissioner said a year ago that there were on file more than 300 appli-

cations for state bank charters.[1] In view of the ease with which new banks obtain deposits, their deposits being guaranteed, the numerous applications for charters were regarded as a public danger. The Commissioner, without authority, had denied some applications, and the legislation of this year has put the issuance of bank charters entirely in the discretion of the Commissioner and the Banking Board. This provision is liked by the bankers, who see danger in the organization of numerous weak banks. Certainly no one will quarrel with rigid investigation of every applicant for a bank charter. His experience, ability, and integrity should be established conclusively. But when a man of experience, ability, and integrity desires to establish a bank in a given locality, is it for any public officer to deny him the right to do so? If the organization of the bank would be a business mistake, and an unprofitable venture, has not our country grown and prospered by allowing its citizens the privilege of making their own ventures and their own mistakes? The same considerations apply to the fixing by the Bank Commissioner of the maximum rate of interest on deposits. This is done in Kansas and Oklahoma. The object is the prevention of reckless overbidding. The result is a "fixing of prices," an interference with the freedom of contract, such as has been thought unwise in modern times.[2]

[1] Proceedings of the Oklahoma Bankers' Association, 1912, p. 87.

[2] The maxima fixed by the Bank Commissioner of Oklahoma are:

3% on accounts of banks, insurance companies, etc.
3% on certificates of deposit 90 days or more.
4% on certificates of deposit 6 months or more.
4% on savings accounts.
No interest on checking accounts, except 3% on public funds.

The following table shows the drift first to the state guaranty system and then to national banking (in $1000): —

ITEMS IN ROUND AMOUNTS FROM OKLAHOMA BANK STATEMENTS

| *State banks*[1] | *Feb. 28, 1908* | *Nov. 16, 1909* | *Jan. 31, 1910* | *Jan. 7, 1911* | *Feb. 20, 1912* | *April 4, 1912* | *Aug. 9, 1912* |
|---|---|---|---|---|---|---|---|
| Number of banks | 470 | 662 | 668 | 695 | 628 | 606 | 596 |
| Capital | 6,233 | 10,767 | 10,679 | 11,570 | 9,841 | 9,079 | 8,867 |
| Surplus | 580 | 881 | 1,079 | 1,386 | 1,163 | 1,126 | 1,162 |
| Due to banks | 476 | 4,537 | 4,142 | 5,692 | 2,436 | 2,251 | 2,124 |
| Individual deposits[2] | 18,032 | 49,775 | 49,928 | 54,756 | 39,391 | 42,629 | 40,181 |
| Due from banks | 7,529 | 20,659 | 17,670 | 25,129 | 12,380 | 14,217 | 11,779 |
| Cash | 2,078 | 4,607 | 4,092 | 4,625 | 3,137 | 3,057 | 2,614 |

| *National banks* | *Feb. 14, 1908* | *Nov. 16, 1909* | *Jan. 31, 1910* | *Jan. 7, 1911* | *Feb. 20, 1912* | *April 4, 1912* | *Aug. 9, 1912* |
|---|---|---|---|---|---|---|---|
| Number of banks | 312 | 220 | 219 | 229 | 283 | 314 | 326 |
| Capital | 12,215 | 10,070 | 9,927 | 10,745 | 12,915 | 13,720 | 14,330 |
| Surplus | 3,063 | 2,674 | 2,736 | 2,925 | 3,279 | 3,632 | 3,933 |
| Due to banks | 4,416 | 8,263 | 7,166 | 11,161 | 7,503 | 10,329 | 8,855 |
| Individual deposits[3] | 38,298 | 41,617 | 43,112 | 47,651 | 53,094 | 67,329 | 67,753 |
| U. S. Deposits | 1,789 | 765 | 693 | 770 | 1,083 | 1,225 | 996 |
| Due from banks | 14,801 | 16,657 | 15,260 | 20,934 | 17,973 | 25,210 | 21,165 |
| Cash | 5,878 | 4,968 | 4,780 | 5,625 | 5,243 | 6,610 | 6,247 |

[1] Includes trust companies.

[2] Does not include cashier's and certified checks.

[3] Includes cashier's and certified checks.

The state system, beginning with 470 banks and $25,000,000 of deposits in 1908, when the guaranty legislation went into effect, grows rapidly in number of banks and in business for three full years, until the state banks number 695 and the deposits amount to $60,000,000. Even the failure of the Columbia Bank and Trust Company in September, 1909, does not stop the organization of new banks and the conversion of national banks into state institutions. The national banks fall off nearly 100 in number, and the deposits of those remaining show only a normal growth.

The national banks, however, begin to gain in numbers and deposits a year before the state banks begin to lose, in fact while the latter are still gaining. There were 219 national banks in January, 1910, and 326 in August, 1913. Their deposits grew from $50,000,000 to $76,000,000. So many state banks left the state system, and so many liquidated or failed, that the 695 of January, 1911, fell to 596 in August, 1913, while deposits decreased from $60,000,000 in the former year to $42,000,000 in the latter. Part of the growth of the state system from 1908 to 1911 partook of the nature of a craze. Another part was due to the inflation of loans. Much of it was sound, legitimate growth, which, as the table shows, has been maintained. There are 126 more state banks in Oklahoma than when the guaranty system went into operation, and their deposits are $17,000,000 greater. Subsequent developments have not invalidated this conclusion stated four years ago: " Given assurance (of the safety of deposits) which it considers adequate, the public will make greater use of banks and more banks will be established."

In spite of all the failures, the people of Oklahoma have not lost faith in deposit guaranty as there administered. People have left deposits in banks that they

knew would fail. After failure many depositors have to be reminded, some of them repeatedly, to call and get their money. One of the members of the Banking Board, who was in Sapulpa when a bank failed there, says that a dog fight in the street would have drawn a bigger crowd. The people have experienced no losses from the state bank failures of the last five years. They refuse to worry over failures present and to come. It is not good for a community that under its banking system the depositor takes no thought whatever for the safety of his deposit.

Many bankers would like to see the guaranty law repealed, but recognize that repeal is for the present hopeless. Meantime they want the state to pay part of the excessive losses they have sustained in assessments for the fund. The Bank Commissioner favors having the state pay any losses in excess of the regular annual assessment of one-fifth of one per cent. He says banks would get better results in the courts if the tax-payers had a direct interest in the enforcement of the banking laws.[1] One of the members of the Banking Board issued a circular letter this year, in his private capacity, stating that the Governor of Oklahoma, Mr. Cruce, had recommended that the state should help in defraying the extraordinary expense the guaranty system had brought upon the banks. The circular called upon the banks to inaugurate a campaign for such relief.

Is this to be the end? Will the state of Oklahoma decide that the guaranty of bank deposits is impracticable, discontinue the guaranty fund, and assume its liabilities? There is little discussion of such an outcome now, but obviously the state must in some way stop the terrific drain on its banks. The boldest optimist cannot hope that the drain will cease of itself.

[1] Proceedings of the Oklahoma Bankers' Association, 1912, p. 91.

Recurrent failures and rumors that some other banks are unsound in a year when short crops make collections slow indicate little chance for the guaranty fund to pay its debts and gain a working balance. After collecting assessments of $1,778,849.36 from the beginning of the system in 1908 to May 1, 1913, the State Banking Board had warrants outstanding June 1 of $418,926.56, with only about $35,000 cash on hand.[1] Abandonment or reconstruction, there are no other ways. Which of these courses will be followed depends on which takes the popular fancy, and that in turn depends on which has the most attractive advocacy. Prediction is futile.

The plan has failed, to repeat, because the loss experienced has far outrun the theoretical ratio. The reasons of the heavy losses, as they have been narrated in the foregoing discussion, may be here summarily restated: (1) The Banking Department was for a long time in politics. (2) Unsound banks were admitted and guaranteed at the outset. (3) The record of bankers has not been properly traced. (4) There has been procrastination in closing insolvent banks and timidity in the face of losses. (5) Economic conditions have been somewhat adverse. (6) The guaranty of deposits has relieved depositors of all necessity for care in selecting banks.

The first four of these reasons are not arguments against deposit guaranty, because they arise from conditions that can be corrected. Politics can be measurably eliminated from the administration of state banking departments. The records of men who wish to organize banks can be found out. Reasonably efficient bank examinations can be had, and weak banks can be closed without the wasteful temporizing that we have seen in Oklahoma. Can any guaranty plan,

[1] Letters from Hon. J. D. Lankford, Bank Commissioner.

however, withstand seasons of bad crops, and can any plan, otherwise adequate, maintain the interest of the depositor in the soundness of his bank? It is by these tests that the guaranty principle must stand or fall. A heavy presumption arises against the principle because of the failure of its application in Oklahoma. We cannot insist upon this presumption, however, until we have compared Oklahoma with the other states, whose guaranty systems have so far not collapsed. In the course of such comparison we may conjecture whether Oklahoma depositors would have retained interest in their banks if the law had provided that in the event of failures depositors should be paid only after the affairs of the banks had been wound up.

## II. Kansas

At the time of our discussion four years ago, the enforcement of the Kansas Guaranty Act had been temporarily enjoined. The injunction was dissolved by the United States Circuit Court of Appeals, and operations under the Act were resumed in 1910, altho it was not until 1911 that the case was finally decided by the Supreme Court.

Participation in the guaranty is optional with the banks, and only one guaranteed bank has failed. That was the Abilene State Bank, which was closed in September, 1910, wrecked by the defalcations of its cashier, who is now in the state penitentiary. The Kansas plan wisely provides that depositors shall not be paid until all assets, including the stockholders' liability, have been realized upon so far as possible, and the affairs of the bank wound up. In the meantime, certificates of indebtedness are issued to the depositors. In the Abilene case certificates amounting to $46,809.75

are held by the creditors, or rather in most cases have been sold to the other Abilene banks. The other banks were satisfied to take them in order to get the business of the depositors of the failed bank, particularly as the certificates bear six per cent interest.

The assessments for the Kansas Guaranty Fund are very small. One twentieth of one per cent per annum is levied on the amount of deposits of each participating bank, less its capital and surplus. This encouragement to the provision of a substantial capital and the accumulation of a good surplus is wise; and the framers of the law fixed small assessments, believing that since losses were only payable after final liquidation, it would be unnecessary to build up a large fund soon. Besides the regular assessment, however, four emergency assessments can be levied any year, making a total of one-fourth of one per cent.

A fund has now been accumulated of $111,159.54 and the banks have deposited $355,977.10 in municipal bonds, school bonds, and the like to guarantee the payment of future assessments. Such deposits are required in the amount of $500 of bonds for every $100,000 of deposits.

Rather more than half the state banks take advantage of the possibility of having their deposits guaranteed, which is virtually to insure them in the State Guaranty Fund. The figures in June of this year stood as follows: [1]

| | Number | Capital | Deposits |
|---|---|---|---|
| Guaranteed Banks | 472 | $9,979,800 | $71,040,906 |
| Unguaranteed Banks | 446 | 8,327,500 | 42,707,937 |

Some changes have been found necessary in the law. The provision excluding from the guaranty deposits

[1] Letter from the Bank Commissioner.

bearing interest, and excluding from participation in the plan banks paying more than three per cent interest on any class of deposits have been found too stringent.[1] The law now provides that all deposits not otherwise secured shall be guaranteed. It provides further that the Bank Commissioner shall fix for each county a maximum rate which the banks in that county may pay on deposits. The Commissioner has fixed rates varying from three to five per cent, since the Kansas counties differ widely among themselves in resources and capital.[2] Any bank officer who shall pay interest in excess of the rate fixed by the Commissioner, or on different terms than he prescribes "shall be deemed to be reckless, and may be removed from office as provided by law."[3]

The rate on certificates issued to depositors in case of insolvency remains six per cent, in the case of deposits that bore no interest. In other cases, the warrants bear the same rate the depositor was to receive under his contract with the bank. As the law stood originally, the holder of a three per cent certificate of deposit would receive six per cent after the failure of the bank.[4]

Banks whose entire deposits are guaranteed, either by the Bank Depositors' Guaranty Fund of the State of Kansas or by a surety company, are now relieved from giving further security for public deposits, except the deposits of the state itself.[5]

It will now be well to examine the relative progress of the state and national banks in Kansas during the

[1] See Quarterly Journal of Economics, vol. xxiv, p. 351.

[2] William Allen White says in The Real Issue — "Kansas, like Gaul, is divided into three parts." These parts correspond to the Commissioner's classification of 3, 4, and 5 per cent counties.

[3] Laws of Kansas, 1911, chap. 61, secs. 1 and 2.

[4] Ibid., chap. 62.

[5] Ibid., chap. 63.

time it has been possible for the state banks to have their deposits guaranteed.

BANK ORGANIZATIONS

| | State Banks Organized | | State Banks Nationalized | |
|---|---|---|---|---|
| | Number | Capital | Number | Capital |
| Two years ending Sept. 1, 1910 | 128 | $2,173,000 | 4 | $79,500 |
| " " " Sept. 1, 1912 | 56 | 1,061,000 | 5 | 100,000 |

NATIONAL BANKS ORGANIZED
(Including Conversions of State Banks)

| | Number | Capital |
|---|---|---|
| Year ending Oct. 31, 1909 | 5 | $315,000 |
| " " Oct. 31, 1910 | 5 | 165,000 |
| " " Oct. 31, 1911 | 4 | 120,000 |
| " " Oct. 31, 1912 | 2 | 55,000 |

ITEMS FROM BANK STATEMENTS IN ROUND AMOUNTS

| *State Banks* | *Sept. 29, 1909* | *Sept. 4, 1913* |
|---|---|---|
| Number of banks | 819 | 928 |
| Capital | $15,810,000 | $18,995,00 |
| Surplus | 4,957,000 | 7,717,000 |
| Deposits | 97,217,000 | 118,170,000 |
| Cash and due from banks | 36,528,000 | 42,023,000 |

| *National Banks* | *Nov. 16, 1909* | *Aug. 9, 1913* |
|---|---|---|
| Number of banks | 206 | 213 |
| Capital | $11,992,000 | $12,312,000 |
| Surplus | 4,887,000 | 6,149,000 |
| Deposits | 83,785,000 | 88,255,000 |
| U. S. Deposits | 651,000 | 1,031,000 |
| Cash and due from banks | 28,960,000 | 31,088,000 |

The increase in the number of state banks is striking. The guaranty system may have been an influence in the organization of some of the new banks, but rarely the moving cause. Deposits are not guaranteed until banks are a year old. Most of the new banks in Kansas, as well as in other Western states, are small institutions, so small that they could not have entered the national

system. The typical capital of a new bank continues to be $10,000, altho, of course, state banks are chartered occasionally with much larger capital. Deposits in national banks increased fully as much as in state banks between 1909 and 1913, and, by proportion more, altho in the meantime the largest national bank in Kansas had moved a few hundred yards into Missouri.

Many of the national banks and a few of the state banks have insured their deposits in the Bankers' Deposit Guaranty and Surety Company of Topeka, a corporation originally formed largely to counteract the influence of the state guaranty law, which was expected to attract business to state banks. The Company is not pushing the deposit insurance feature of its business, however, altho it has never had a loss. It is understood to insure the deposits of about 100 banks, practically the same number it insured three or four years ago.

It is significant that the number of banks participating in the Depositors' Guaranty Fund is increasing.[1] The fact that they cannot participate for a year after they are organized means that the banks now coming into the scheme have decided, after opportunity to consider the matter, that the guaranty of their deposits by the state fund will increase their deposits somewhat, or make their deposits rather more stable, or both. It is not that the sign "Deposits Guaranteed by Bank Depositors' Guaranty Fund of the State of Kansas" draws business in quantity from the other banks, as it did in Oklahoma in the first year or two of the experiment. It is that occasionally a deposit comes in from a man who, the cashier knows, would not have patronized the bank if its deposits had not been under guaranty. Or a deposit remains for a time whose

[1] Letter from the Bank Commissioner.

owner would have made haste to use it in the days when every bank lived to itself alone.

If any system of insuring deposits in a fund administered by the state is to endure, it should have some of the features of the Kansas guaranty plan. The allowance for capital and surplus and the payment of depositors at the final liquidation only are admirable. It is unwise that the Guaranty Fund should be limited to $500,000, for there are many single banks in Kansas with deposits larger than that sum, and half a million is too small a reserve for $70,000,000 of risks. It is still more unwise that the assessments while the fund is being accumulated should be only one-twentieth of one per cent per annum. That rate is theoretically good, but it builds up the fund far too slowly.

Further comments on the Kansas scheme can best be made after a study of Nebraska and Texas.

## III. Nebraska

It is now fifteen years since a national bank failed in Nebraska. It is eight years and more since a state bank failed, and then the depositors lost only $2,000. "In Nebraska," writes Mr. E. R. Gurney of Fremont, a keen observer, "we have a population of mixed races, a very large percentage, however, running to foreign born. These foreign people are hard working, economical and almost always good pay. Their notes in most any bank can be approved. Moreover, our state has reached an age where stability is the rule, and more than all other circumstances, is the fact that we have had a capable and vigorous administration of our State Banking Department for something like fifteen years past. Our banks, therefore, are sound from the standpoint of the assets and also from the influence of supervision."

It is true that in many Western states, the foreign born farmers are regarded as more certain payers than the Americans. Less venturesome, they are sometimes better risks for the banker, even if, or probably because, they are satisfied with modest results. If they develop a country less rapidly than Americans develop it, their progress is steadier and their notes in bank are not subject to so many vicissitudes.

What Mr. Gurney says of the Nebraska Banking Department is also true. The Secretary of the Board, Mr. Royse, has done such excellent work that the changing state administrations of ten years have wisely kept him continuously in office.

The time when the Nebraska deposit guaranty act of 1909 was to take effect had not arrived when the United States Circuit Court enjoined the state officials from putting it into operation. The Act was upheld by the Supreme Court, however, with the Oklahoma and Kansas statutes, and the first assessment was collected July 1, 1911.

The legislature had made a few amendments in April, but the working plan was essentially that adopted in 1909. There were four semi-annual assessments of one-fourth of one per cent of average deposits. The last of these was paid January 1, 1913. Further assessments are one-twentieth of one per cent semi-annually, as originally provided. New banks still pay one per cent of their average deposits the first year. It is now provided that when the Guaranty Fund reaches one and one-half per cent of the deposits of the state banks, assessments shall cease until the fund is depleted below one per cent of deposits. To correct an ambiguity, the act of 1911 provided that no bank which had paid the assessments and otherwise complied with the banking laws should be required to give any further security

for public deposits. This is different from the Oklahoma plan, where special security is given and deposits specially secured are not within the guaranty.

The only important amendment adopted this year permits the investments of a bank to equal ten times its capital and surplus, instead of eight times, which was the limit fixed in 1909.

The original act of 1909 prohibited private banking and required the thirteen private banks to procure state charters or discontinue business. It made the guaranty scheme obligatory upon all state banks. These provisions are unchanged.

Where economic conditions are settled and banking stable, it is not to be expected that changes in the banking laws will effect a marked change in the disposition of accounts. Nevertheless, the reports of Nebraska banks since the United States Supreme Court decision (January 3, 1911) make an interesting study. Important items from the reports of state and national banks a year before and just after the decision are here presented in comparison with the reports of August, 1913.

ITEMS FROM BANK STATEMENTS IN ROUND AMOUNTS

| *State Banks* | *Feb. 12, 1910* | *Feb. 17, 1911* | *Aug. 26, 1913* |
|---|---|---|---|
| Number of banks | 664 | 668 | 710 |
| Capital | $12,362,000 | $12,729,000 | $14,380,000 |
| Surplus | 2,245,000 | 2,427,000 | 3,264,000 |
| Deposits | 77,991,000 | 74,105,000 | 94,194,000 |
| Due from banks | 18,726,000 | 19,960,000 | 22,924,000 |
| Cash in banks | 4,452,000 | 4,476,000 | 4,889,000 |
| Depositors' Guaranty Fund | | | 811,000 |

| *National Banks* | *March 29, 1910* | *March 7, 1911* | *Aug. 9, 1913* |
|---|---|---|---|
| Number of banks | 227 | 237 | 241 |
| Capital | $14,810,000 | $15,695,000 | $16,270,000 |
| Surplus | 6,035,000 | 6,784,000 | 10,319,000 |
| Deposits | 121,283,000 | 119,087,000 | 128,663,000 |
| U. S. Deposits | 1,060,000 | 1,035,000 | 1,241,000 |
| Due from banks | 29,479,000 | 33,006,000 | 34,103,000 |
| Cash in bank | 10,726,000 | 10,477,000 | 11,682,000 |

For a year before the decision was announced state banks had been nationalizing, some of them undoubtedly for the purpose of escaping the assessments. Thirteen state banks took out national charters in 1910, and 11 nationalized in 1911.[1] On the other hand, new state banks were organized pretty freely, with an eye to the prestige of guaranteed deposits. Nationalization has now ceased, for there was not an instance in Nebraska in 1912; but the organization of state banks continues.

BANK ORGANIZATIONS

| | State Banks Chartered | | State Banks Nationalized | |
|---|---|---|---|---|
| | Number | Capital | Number | Capital as State Banks |
| Nov. 16, 1909 to Nov. 10, 1910 | 28 | $420,000 | 13 | $630,000 |
| Nov. 10, 1910 to Dec. 5, 1911 | 24 | 492,000 | 11 | 420,000 |
| Dec. 5, 1911 to Nov. 26, 1912 | 27 | 775,000 | 0 | 0 |

NATIONAL BANKS ORGANIZED

(Including conversions)

| | Number | Capital |
|---|---|---|
| Year ending Oct. 31, 1910..... | 20 | $880,000 |
| " " Oct. 31, 1911..... | 12 | 1,195,000 |
| " " Oct. 31, 1912..... | 1 | 25,000 |

On account of nationalizations and liquidations, the state banks lost ten in number between the February and June reports in 1911, at the time the guaranty law was going into effect, and their deposits fell off more than $2,000,000. From March to June of that year the national banks increased by eight, and their deposits by $1,400,000. Since that time the state banks seem to have been somewhat preferred. The table shows that they have gained forty-two in number and $20,000,000 in deposits in two years and a half, while the increase

[1] Letter from the Deputy Comptroller of the Currency, April 23, 1913.

for the national banks is only four in number and about $9,500,000 in deposits.

It would seem that some of the state bankers now see a little benefit arising from the guaranty scheme. When it was first projected they were bitter over any plan that would tax them to pay the losses of other bankers. There have been no losses, however, and gradually a few extra deposits have come in, — not deposits of large amounts, but here and there $2,000 or $3,000 from people who would not have been expected as depositors, at least as depositors in a state bank without the guaranty. Most of the state bankers have now dropped their active fight on the guaranty plan, and more than a few seem pleased with the way it is working. They are advertising the guaranty on their checks and deposit tickets, and making the most of the system they formerly opposed.

The figures show that the national banks, while not growing so fast as the state banks, have suffered no drain. The national bankers say that the deposits that have left them for the guaranteed state banks have been scarcely perceptible. In a state where no national bank has failed in fifteen years, it would have been surprising to find that state bank guaranty had made national bank depositors uneasy.

The virtual acquiescence of the state bankers is due in part to the fact that no money has been taken out of their banks. The assessments are merely set aside as deposits to the credit of the State Banking Board. The bankers regard this account as a special surplus, and so, in a sense it is; but it is a common surplus, and when it is drawn upon (for Nebraska cannot always escape failures), there will be disappointment and possibilities of trouble. The failure to collect assessments, to get the taxes out of the hands of the taxed

banks, still seems a defect in the Nebraska law, altho the bankers like it.

Another defect is the provision for paying depositors as soon as a bank fails, or as soon as the receiver has calculated how much cash he must draw from the guaranty fund to supplement the cash in the failed bank. The failure of the Oklahoma plan was due to this same provision as much as to any one cause. A series of failures would require immediate large expenditures from the fund, and make emergency assessments necessary. But a series of failures would come, if at all, at a time when all banks were hard up, and when an emergency tax would be a burden and perhaps a danger.

The Nebraska plan is good in that it has accumulated a fund of nearly $1,000,000. It is bad in that it leaves this fund with the very banks that have it to pay, and in that it promises to pay deposits immediately on failure.

It is to be observed, however, that under the administration of the Nebraska banking department the promise to pay depositors immediately on failure seems not to have caused reckless banking. And, as bearing on the existence of a need of deposit guaranty or insurance, the fact that deposits in state banks are guaranteed is found to influence deposits somewhat, even in a state where bank failures have for years been unknown.

## IV. Texas

The deposit Guaranty Act of Texas has never been attacked in court. It has been in operation since January 1, 1910, and the results must be called favorable so far. The fiscal year of the Texas banking department ends August 31st. No bank failed at all the first year. One failed the second year, two the third

year and three between August 31, 1912, and the present date (October 9, 1913).

Taking the failures in their order, the Harris County Bank and Trust Company of Houston suspended August 7, 1911, and the examiner uncovered forgeries, false entries, and paper placed in the bank for fraudulent purposes. The president left before he could be apprehended. The guaranty fund was drawn on for $111,649.90 and an emergency assessment for that amount was levied on the guaranteed banks. In 1912, however, a 50 per cent dividend was paid to creditors, and half the assessments returned to the banks.[1]

The Paige State Bank, capitalized at $10,000, was taken over by the banking department early in 1912, because the president had placed $19,000 of worthless paper in the bank. The guaranty fund was called upon for $13,697.90.[2]

The last bank that has cost the fund anything is the First State Bank of Kopperl. It was closed December 6, 1912. Then it was discovered that S. J. Spotts, the president, had been previously convicted of violation of the National Bank Act, and had served a term in a Federal prison. Spotts was found in Los Angeles, was brought back to Texas for trial, and on a plea of guilty was sentenced to four years in the state penitentiary. The deposits of the bank were $16,000 and in paying them $8,000 was used from the guaranty fund.[3]

The three banks that failed subsequently were liquidated without calling upon the fund.[4] The guaranty fund has, therefore, paid only $133,347.80 on account

[1] Report of Commissioner of Insurance and Banking, 1911–12, p. 19.

[2] Ibid., p. 21.

[3] Ibid., p. 19.

[4] Telegram from W. W. Collier, Commissioner.

of failed banks in about four years, and has recovered more than $55,000 of that amount. The showing is considered excellent, and new banks have been organized in large numbers to keep up with the rapid growth of the state. For the fiscal year 1911, 109 state banks and trust companies with capital of $2,522,000 were authorized to begin business. The next year the number was 77 with $3,169,000 capital, but 8 of these were trust companies with $100,000 or more capital each. The 8 had together more than half of the total new capital of the year. The typical new organizations were still banks with the minimum capital permitted, $10,000. In the fiscal year 1912, 23 state institutions with $1,110,000 capital were incorporated.[1]

The Texas banking report for 1913 is not yet at hand, but new organizations must have been numerous, for the number of state banks and trust companies increased from 709 in June, 1912, to 776 in April, 1913. For comparison, the statistics of national bank organizations are here set down. The new banks include conversions of state banks. The data as to the new banks are for the years ending October 31st, and as to the conversions, for calendar years.

| | National Banks Organized | | State Banks Changed to National Banks | |
|---|---|---|---|---|
| | Number | Capital | Number | Capital as National Banks |
| 1910 | 14 | $1,875,000 | 2 | $140,000 |
| 1911 | 21 | 1,255,000 | 4 | 215,000 |
| 1912 | 16 | 2,650,000 | 6 | 425,000 |

Obviously bankers are not afraid to organize under the state system and remain in it, and yet a considerable amount of capital is being invested in national banking. A comparison of bank statements tells much the same

[1] Report of the Commissioner of Insurance and Banking, 1911–12.

story of satisfaction with both systems as administered in Texas, the state system being apparently somewhat preferred.

ITEMS IN ROUND AMOUNTS FROM TEXAS BANK STATEMENTS

| *State banks*[1] | *Nov. 16, 1909* | *April 4, 1913* |
|---|---|---|
| Number of banks | 502 | 776 |
| Capital | $ 16,114,000 | $ 29,451,000 |
| Surplus | 1,475,000 | 5,806,000 |
| Due to banks | 6,541,000 | 7,664,000 |
| Individual deposits | 43,328,000 | 86,485,000 |
| Due from banks | 18,051,000 | 27,556,000 |
| Cash | 5,324,000 | 9,281,000 |

| *National banks* | *Nov. 16, 1909* | *April 4, 1913* |
|---|---|---|
| Number of books | 519 | 514 |
| Capital | $ 42,393,000 | $ 49,625,000 |
| Surplus | 19,551,000 | 25,592,000 |
| Due to Banks | 38,744,000 | 52,209,000 |
| Individual deposits | 164,618,000 | 209,411,000 |
| U. S. Deposits | 1,137,000 | 2,043,000 |
| Due from banks | 59,693,000 | 80,167,000 |
| Cash | 22,314,000 | 26,535,000 |

It appears that since the enactment of the guaranty law, the state banks have increased fifty per cent in number and their deposits have doubled. There were five more national banks in 1909 than in 1913, but individual deposits in national banks have increased twenty-five per cent and if we could make the comparison after the cotton is marketed this fall, a still larger growth would appear.

Nominally it is optional with Texas banks whether or not they shall have their deposits guaranteed. Any bank may, if its directors prefer, file annually with the Commissioner of Insurance and Banking "a bond, policy of insurance, or other guaranty of indemnity" equal to its capital stock, or, if it is a private bank, "in

[1] Includes Trust Companies.

an amount to be fixed by the Commissioner." This option has not proved attractive, however. A bond or policy procured from a bonding or an insurance company is expensive, and it is embarrassing to ask friends, customers, or even directors, to make the bond. Furthermore, a bond with individual sureties has little effect in attracting or reassuring depositors. In 1909, only 42 banks had elected to furnish bonds. In 1912, the number was only 53.

It has not been found necessary to change the original guaranty law materially. It still provides for an initial assessment of one per cent of deposits, and for subsequent assessments of one-fourth of one per cent per annum, with power to levy emergency assessments, not exceeding two per cent in any year, in case the fund is diminished. Assessments are to cease when the fund reaches $2,000,000, The fund is now, October 9, 1913, $778,824.[1]

The legislature this year, following the example of Kansas and Oklahoma, has provided that the State Banking Board shall refuse charters for new banks where there is not public necessity for them.

Much of the credit for the apparent success of the guaranty system in Texas is accorded to Mr. B. L. Gill, who was Commissioner of Insurance and Banking from January, 1911, to this summer.

Texas, with its rapid economic development and its hundreds of new banks, subject to all sorts of vicissitudes, can scarcely hope always to get off so luckily in failures. The organization of a great many banks during a time of rapid settlement and development has, in other states, been followed almost always by losses to a considerable number of banks and by some bank failures. A good fund is being accumulated in Texas,

[1] Telegram from the Commissioner.

however, and the banking department seems to be efficiently organized and administered. The state banking system is getting into position to withstand some rather heavy shocks, if they come. If they do not come too soon, the Texas guaranty plan will probably survive. This prediction could be made with some confidence if the law were amended to provide for payment of depositors only upon the final liquidation of failed banks; but no such amendment is now being urged.

## V. General Arguments and Conclusions

It is now evident that the cause of the Oklahoma bank failures was not deposit guaranty alone, but guaranty plus ineffective examinations, insufficient scrutiny of the previous records of bankers, and unfavorable economic conditions following the period of settlement and rapid growth. This is shown by the fact that in the other states where deposits are guaranteed failures have been few.

The guaranty system has given opportunities to some reckless and criminal bankers in Oklahoma, but it has not turned honest bankers into rogues there, or in the other states we have studied. Deposit guaranty is not stockholders' insurance. Stockholders must lose their whole investment before the guaranty fund suffers any loss, and there is, therefore, not even a financial incentive for a good banker to become a rascal. He may be tempted by guaranteed competition into an unwonted, perhaps unwise liberality, but not to a dangerous extent, if we can judge by the present experience of Kansas, Nebraska, and Texas.

It remains to consider what are the best methods of guaranteeing deposits and whether, in fact, such

guaranty is desirable at all. It is unnecessary here to repeat the arguments stated at some length in the previous article; but one suggestion then advanced should be withdrawn. Deposit insurance by private corporations was mentioned as a possible solution of the problem. But this is now evidently not the solution that is to be used, if the problem is found to be worth solving. While such corporations could select risks and limit their size and distribution, and while there is an example in Kansas of the successful operation of such a company, it is obvious, nevertheless, that if deposits are to be guaranteed or insured on any considerable scale, it will be through the banking departments of the states or conceivably of the United States. The efforts to organize other deposit insurance companies and put them in operation have not met with success. The Kansas example remains solitary.

The stimulus to reckless banking is not the chief danger to the success of deposit guaranty. Kansas, Nebraska, and Texas have so far repressed such tendencies. A greater danger has just been mentioned, the impossibility of limiting the size of single risks or avoiding the concentration of risks in single localities. Whether this danger will prove fatal to the success of the plan, depends largely on the size of the fund accumulated by the time the big losses occur. The Oklahoma fund is insolvent now. Texas is accumulating a $2,000,000 fund, Kansas a $500,000 fund, and Nebraska a fund of one and one-half per cent of deposits, say $1,500,000. Each state should considerably advance the limit now fixed on its fund, and Kansas, at least, should increase its assessment rates. There would then be some probability of establishing reserves large enough to take care of as many failures as can reasonably be expected in these states under present day conditions.

Another danger, social rather than financial, is the real or supposed necessity of accompanying the establishment of the guaranty system with grants of almost despotic power to the state banking departments. The guaranty of deposits is so powerful an inducement to depositors, legislators believe, that for fear of its misuse by the incompetent or unscrupulous the banking departments are empowered not only to regulate and supervise banks, but to say what rates of interest they shall pay, and whether the citizens shall establish more banks. In some states both these powers are exercised. This may be "medieval," but, as in the question whether deposit insurance should be provided by the state or by private corporations, it is sufficient to recognize the irresistible tendency in many forms of industry toward state control. If the state can fix railroad rates, no doubt it can fix rates of interest on deposits. If it can regulate banks, no doubt the power to fix their number and forbid new organizations regarded as superfluous will be upheld. Doubtless the part of wisdom lies in trying to guide this tendency instead of fighting it.

The vital question is whether the public needs greater assurance of the safety of its deposits than can be afforded by the resources of a single bank in a single town. Any reader who may be interested will find the writer's views stated carefully in the article before referred to.[1] Even in states where banking is soundest the bare possibility of failure, and the knowledge of the blight it would bring to business plans and to household life, keeps many people from the banks. They cannot be absolutely sure. They cannot detect the few cases of unsoundness, some or all of which escape bank examiners, business men among the customers, and the

[1] Quarterly Journal of Economics, vol. xxiv, pp. 373 et seq.

directors themselves. There is, therefore, even in the most prosperous days, a good deal of hoarding, and, what is worse, a failure to use the modern labor-saving machinery of exchange. Some additional business comes to guaranteed banks even in states of settled economic and social conditions, like Kansas and Nebraska. The scheme would not have been tried but for the vivid memory of the distress caused by the suspension of cash payments in 1907. Once in force, the plan seems to bring satisfaction to some depositors.

The plan does not spread. Many other state legislatures debated it in the first few years, but less is heard of it now. South Dakota, as we anticipated, has left its plan unused.[1] It would take many failures close together, or a pretty general suspension of payments, to bring about the adoption of the plan now where it is not already in force. If Congress provides an effective method of mobilizing reserves and providing ready credit on farmers' paper, little will be heard of guaranty for some time.

This is not to say that Kansas, Nebraska, and Texas will discontinue the plan. Unless it is causing losses and weaknesses underneath the surface, and the writer cannot find that such is the case, there is not likely to be much agitation for repeal in these three states. In some of them, at least, guaranty funds will be accumulated sufficient to permit of the continuance of the system. Whether the plan will gradually be adopted in other states depends on the force of the present social tendency to distribute more widely, by legislation, the good and evil of life. Workingmen's compensation is analogous. The tendency underlying this legislation and the guaranty legislation seems to the writer exceedingly strong. If this is so, a state here and there will

[1] Ibid., vol. xxiv, p. 360.

from time to time supplement its service of bank regulation and supervision by enabling, if not requiring, the banks to effect insurance in a state-administered fund for the benefit of depositors.

Such insurance is more needed in some localities than in others and should be optional with the banks. If an old bank with large deposits is satisfied to rest on the reputation it has been years in building, it would be wrong to make it pay taxes or premiums to provide for the depositors of other banks. It is safe to say that once such legislation is in force, there will be banks to take the insurance or accept the guaranty. The state for the present will be doing enough for depositors when it enables those who are not sure of the stability of banks to do business with banks whose deposits are insured.

The insurance should not be paid or the guaranty redeemed, until, as in Kansas, the assets are finally liquidated and the bank wound up. To try to pay when the banks close is to attempt the impossible. Economy and social policy alike favor the Kansas plan, for the delay stipulated in payment will keep the depositor from such carelessness in choosing his banker as has been seen in Oklahoma. This is true even if the depositor believes that other bankers would probably cash his guaranty fund certificates in case his own bank failed.

The fund must be large, — not less than two per cent of deposits and larger than that in states where there are several banks with deposits many times the average. Other features desirable in deposit guaranty legislation have been sufficiently discussed in the foregoing pages.

Bank failures have not been the chief defect in American banking. The immobility of reserves and the lack of proper mechanism for the seasonal expansion and

contraction of credits have been far greater. Mobilizing the reserves and providing elastic credits will solve many problems. Our banking system, nevertheless, will remain individual, and our banks numerous and independent beyond anything known abroad. The possibility of failures will be ever in the thought of many, and occasional failures will be inevitable. How to minimize the resulting social and financial loss will remain a problem worthy of the efforts of banker and economist.

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# THE SOCIAL POINT OF VIEW IN ECONOMICS. I


## SUMMARY

I. Importance of the distinction between individual and social points of view, 115. — II. General meaning of the social point of view, 121. — 1. What is society ? 121. — (1) Social-contract theory, 122. — (2) Social-organism theory, 123. — (3) Common-consciousness theory, 126. — (4) Conscious-commonness theory, 128. — 2. The application of the concept of society, 132. — (1) Society as a whole, 133. — (2) The social individual, 133. — III. The special meaning of the social point of view in economics, 136.


## I. Importance of the Distinction between Individual and Social Points of View

Economics is beset with " nice distinctions," leading well nigh to strangulation by definitions. Some of these, however, are of fundamental importance, and among such is the distinction between the individual and the social points of view. In this paper an attempt is made to demonstrate the fundamental importance of this distinction, and to indicate its logical significance. In another paper the distinction will be further developed in an applied way, and an attempt will be made to work out a true and consistent use of " the social point of view," with regard to the main economic concepts.

At the very threshold of economic analysis we are met by the troublesome concept of " wealth," and almost immediately, as we attempt to gain a measurable material with which to work, we realize that what is

regarded as wealth by the individual is not necessarily regarded as wealth from the point of view of the whole group of which the individual is a member. In defining wealth to an inquiring class, what teacher has not had to fall back upon difference in point of view? And so it is with "income." Of course the idea of production of wealth must vary where the concept of wealth itself varies, and from the beginning of economic science differences of opinion as to what activities are "productive" have existed. Those who have insisted that wealth is material have logically enough taken an individual point of view; for, according to that point of view, the significance of exchangeability among individuals is emphasized. The same thinkers have frequently ascribed productivity solely to those who work on tangible commodities.[1] It will be observed, too, that it is in accord with the fact that generally material things alone are the object of theft, that your thorogoing individualist can class predatory activities as productive. At the other extreme stand those whom we may call societists. These men generally include a great variety of intangible elements and services in wealth, and logically enough they emphasize not a stock of material goods but productive *power or capacity* (as a source of income). Their concept of production is correspondingly broad. Such ideas are represented by the Nationalist, Friedrich List.

Again, the problem of value has been called the heart of economic analysis; and is it not? But who

[1] According to an individual point of view, wealth must be exchangeable and appropriable by individuals. These qualities, together, almost necessitate the exclusion of immaterial items. Of course, there is a fringe of such intangible items as good-will, franchises, and other claims to things: but these are recognized by all to be in a different class, as their transferability is more limited and their possession more precarious. Moreover, an individualist does not necessarily mean one who entirely overlooks society (in a certain sense, as an aggregate of individuals) and so the duplication involved in including claims with material things has been seen by most individualists.

does not know that some economists have regarded value as an objective quality or ratio derived from a comparison of unrelated individual estimates, while others speak of "social value" and regard it as caused and determined directly by estimations of society. And, following the same bents, one group considers marginal utility as a purely individual phenomenon and demand as the sum of individual demands, while another group considers marginal utility and demand as more or less purely social phenomena.

Now wealth and value are fundamental concepts, — the very basis of economic science. These two points of view cannot exist with regard to the fundamentals without permeating the whole science. Accordingly, in less fundamental concepts and principles, we find differences among economists, and discrepancies in usage by the same economists, which a little analysis shows to be based upon the difference between the social and the individual points of view. Take the idea of capital, for instance. Capital being a form of wealth, the tendency to correlate material and individual on the one hand, and intangible and social on the other hand, works in a way similar to that found in the treatment of wealth, and there is a similar fringe of appropriable intangibles that are in a doubtful category. The distinction, however, has appeared most notably of late in a tendency toward regarding capital as an abstract fund of income-yielding property which may be embodied in land, machines, or other concrete goods. This, we are told, is in accordance with the usage of the business man. True. And the business man is an individual, — an individual whose usage is not wont to be based upon a realization of the beauties of society. Those economists, however, who hold to the idea that capital consists of concrete

instruments produced by man are taking a social point of view. To the individual business man it is apt to appear that land can be made, and is limited in supply. He can invest his capital in it just as he can in machinery. But to a social group as a whole, being more comprehensive than any individual, the limitations of land supply and its special adaptations become more manifest and important; and the individual's conception of investment and income does not apply. The principle of diminishing returns, also, has been variously treated according as the writer was reasoning from an individual or a social point of view. From the latter standpoint, it is generally taken to mean diminishing quantities of produce in a technological way; from the former, diminishing quantities of value, with or without change in output or yield. The reason for this is not far to seek. For society, — so would run the reason, if it were formulated, — the significant thing is the amount of physical products on hand to gratify wants, and the more the merrier; but the individual grows " wealthy " by reason of the scarcity of his commodity, which causes it to command a high price; therefore, it is the technological diminution of returns that concerns society as a whole, and exchange-value diminution concerns single individuals.

The concept of cost also furnishes a good illustration of the way in which one's point of view colors one's theory. Thus, to the individualist it seems that " opportunity " forgone constitutes a cost, and accordingly we find him and uncritical followers introducing the notion of " opportunity cost." [1] This, as the writer has shown elsewhere, is the result of overlooking, on the one hand, the social significance of cost in limiting supply; and, on the other, of stopping short with the

[1] See Haney, " Opportunity Cost," American Economic Review, vol. ii, no. 3.

entrepreneur or some other individual, thus failing to consider the broader ultimate factors. In a similar way, the notion that rent is a cost of production in the same sense that payments for labor and capital are costs is a product of an individual point of view which regards the individual's alternative use for his land as an ultimate determining fact.[1]

Finally, the nature and scope of the science as a whole is affected. Do not some economists write as tho there were no society, and ever keep the individual first; while others begin by vociferously insisting that economics is a social science, and always keep the individual subordinate to society? But, after all, how many proceed from any clear understanding of what societies and individuals are?

It will generally be found, too, that those who emphasize society in a certain way — as a separate entity — are apt to inject a large element of ethics into their thinking. This is natural enough, for if society exists as a separate entity, the chance for clashes of interest between it and the individual are multiplied, and the ethical doctrine of self sacrifice is necessarily invoked.

There is no need to multiply instances. Probably not an economic category, concerning which economists have differed, has failed to vary in connotation and denotation because of differences in the points of view of those who used it.

The reader may already have thought of instances in which the same economist has used two definitions or followed two trains of reasoning, one of which, according to the preceding analysis, would indicate a social point of view, the other an individualistic way of looking at things. But is such inconsistency

[1] See the writer's article on "Rent and Price, 'Alternative Use,' and 'Scarcity Value,'" in this Journal, vol. xxiv, pp. 119 ff.

rare? Closer examination must convince him that it is most common for confusion to arise when the significance — nay the very existence — of a distinction is not actually realized. Thus, when we find entrepreneur standpoint in distribution and social standpoint in value (Seager?), or business man's concept of capital together with social-organism concept of value (Clark), or opportunity cost listed with pain cost, or narrow individualistic "laws" of production jostling broad ethical precepts of distribution and use, we may be surprised, but none the less convinced that confusion has reigned over greater or less domains.

Another way of bringing out the importance of this matter is to reflect that the nature of society must affect individual action — the two being interdependent — and so affect most economic laws. Indeed the laws of all social sciences must proceed from some concept of society. This is illustrated by the differences among the conclusions of economists who hold different notions concerning the nature of society. Does society come first, and exist as a separate entity superior to the individual, or *vice versa*? Is it based upon contract, instinct, imitation, or rational consciousness of like interests? Upon the answer to these questions the economist's treatment of his science and the nature of its laws must in large part depend.

Dr. Schumpeter, it is true, has dismissed this subject as unimportant for pure economic theory.[1] Briefly, his ground is that economists need not bother themselves with a consideration of motives and sub- or super-individual *activities*. But, even aside from the not unimportant point that economists have in fact taken these things into consideration and in consequence have reached different conclusions, the ques-

[1] Das Wesen und der Hauptinhalt der theoretischen Nationalökonomie, chap. vi.

tions remain, what is an individual? What are individual acts? The matter is by no means so simple as Dr. Schumpeter seems to think. There *are* two things (however closely interrelated): "individual" and "society." Accordingly, there *are* at least two points of view which may be taken toward nearly all economic goods and activities. Even the concept of an individual self is not practically separable from that of other individual selves. In short, the distinction between the individual and the social points of view exists in the nature of things and must be reckoned with in its particular manifestations by each of the social sciences.

## II. The General Meaning of the Social Point of View

### *1. What is Society?*

Thus far the expression "a social point of view," has been used. This has been done advisedly; for what *the* social point of view is depends upon each thinker's concept of society. There may be as many social points of view as there are viewers. On this subject an unusual degree of confusion has existed, because there has been no attempt by economists to grasp clearly the true nature of society and then apply it in a logically consistent way in their thinking. As a first step it seems desirable to attempt a broad classification of the most important general concepts of "society" and "social."

At least four concepts of society in general have influenced economists, consciously or unconsciously, in their theories, and are worthy of consideration. First come two extreme concepts, one ancient, the

other of relatively recent date; and these will be familiar to most economists. I refer to the "social-contract" and the "social-organism" theories.

(1) The *social-contract* theory may be briefly disposed of; for probably no one now holds it in its pure form. Nevertheless it exerted no small influence upon early economists. According to this theory, originally no society existed and a more or less unmodified individualism reigned. Such was the state of nature described by Hobbes, Locke, and Rousseau. Society, the thought of which was not separated from that of the state, was formed by a voluntary, deliberate agreement among its individual members. Thus society was an abstract something entirely separate from its members. The individual came first; and, conscious self-interest having been the cause of society, it remained the moving force. Only such phases of individual life were embraced in the social existence as might be necessary for protecting the lives and property of the individuals concerned, and the governmental aspect of social action was decidedly the dominant one. The theory, as it found expression in the thought of the Classicists, meant an extreme, rationalistic individualism; which, in turn, meant a tendency toward certain theories of wealth, value, productivity, as indicated above. Of course there are different brands of individualism, just as there are of socialism. The distinguishing marks of the older social-contract individualism were its rationalism and its mechanical character. Men were supposed to be guided by self-interest and, as the self was looked upon as a material atom exclusive of other selves, each self's interests were apt to clash with those of other selves — and of society.[1] Naturally the limitations of natural resources

[1] Fite, Individualism.

and costs were emphasized, and the possibilities of organization were given little attention.

(2) At the other extreme comes the concept of society as a *social organism.* Sometimes this concept is based on mysticism, sometimes on biologial analogy, sometimes on historical continuity; but always, as in the social-contract concept, those who hold it are apt to fall back upon the " natural " in explanation. Society is thought of as an entity which is either separate from its members (Clark) or fused with them (Schaeffle). The reason for its structure and purpose are to be found within itself. Society comes first and all economic activities are thought of as social processes. All phases of social life are fused. As found in the thought of typical socialistic, nationalistic, and sociological economists, the social-organism theory leads to an extreme " societism " and to a submerging of the individual. Differences among individuals are overlooked as insignificant, including both differences in capacity and in possession. Indeed, it is a general criticism of the thought of these theorists that they reason either as tho there were a communistic state or a uniformity of individuals. Thus they seek to grasp and to balance " social utility " and " social cost " *directly and immediately,* as tho society existed as some conscious entity apart from or above individual units. Instead of composing demand and supply from individual marginal utilities and disutilities they would draw curves for society as a whole directly. Those who are socialists assume a " just " (equal ?) distribution and so are able to disregard important existing inequalities; but those who accept the existing system must resort to some idea of organic harmony or to an average. The individual, then, instead of being guided by self-interest, acts as a cell which is nourished

and controlled by social processes, and harmony comes not through clash of interests but through identity.

The preceding theories are now of relatively slight importance: one is dead, the other is rapidly dying. Both are alike in that they set the individual over against society. They both rest upon metaphysical bases, the one assuming a natural state of individual freedom, the other a natural social organism. In the one the individual is a mechanical atom; in the other he is a subordinate cell. Yes, in one, value is measured by contract labor cost, and in the other by social labor cost (Clark). Truly, extremes meet!

Of late, however, there has come into prominence a more refined (and less extreme) modification of the social-organism theory, which is based upon psychological analysis and centers in discussions of the "social mind." As worked out by Professor Cooley [1] and followed by Dr. Anderson,[2] this refined psychological theory is less liable to lead to unsound results, and with most of what its proponents say no fault is to be found. Indeed, with these writers the discussion may become a mere quibble over the meaning of the word " organism." The danger lies in an over-emphasis of society. Thus, tho Professor Cooley surely speaks well when he says that the individual is a differentiated center of psychical life, having a world of his own into which no other individual can fully enter (p. 9), and that the " social mind " is the expression of a vital co-operation of individuals (page 4), he also says that the individual's acts are *the outcome of the whole* (page 4). Dr. Anderson's statement of the case appears to include more of the cruder biological idea. " Society is an

[1] Cooley, C. H., Social Organization, 1909 (1912 edition cited).

[2] Anderson, B. M., Social Value, 1911.

organism," he says (page 83); and goes on to argue that this is true because (*a*) an organism has different parts with different functions, which parts (*b*) are interdependent, and (*c*) it has a central theme, not externally imposed, to the working-out of which the different parts contribute. But in what sense has *society* these things ?[1] Hardly in the sense that the individual organism has them, or in any ordinary sense of the word organism. Can an organism be made up of parts which are themselves organisms ? Do the parts of an organism, interdependent and co-operating as they are, each duplicate the complete round of functions of the organism as a whole ? Whence does society get its " central theme," and what is that theme? Does it not come from the conscious co-operation of potentially independent individuals, and is it not the well-being of those individuals ? It is logical, perhaps, to talk of a central theme of society, if we regard it as the harmony of co-operating individuals; but we cannot stop there, for the question remains, whence comes this co-operative harmony ? — and the answer takes us to the individual. Of course this gets us into a circle, but circles have centers and starting points, and for purposes of analysing social valuations we must work out from and back to individual estimations. Dr. Anderson goes on to state that there is a social mind; and that individual differences among the minds of men rather prove the *organic* character of the social mind, by introducing the fact of differentiation. (As tho differences in parts could make an organism!) And then, integration being obviously necessary, he adds: " The integrating element is found in the points which the individual minds have in common" (page

[1] See Coker, F. W., Organismic Theories of the State, Columbia Studies, vol. xxxviii, no. 2.

85). But this gives us but a mechanical integration: a mere identity of minds constitutes no living thing or organism, but a blind commonness of states of consciousness. Dr. Anderson himself says that his social "organism — or the parts — is not necessarily conscious" of the social theme. Few if any thinkers would now deny the existence of differentiation; the rub comes in the manner of the integration.

Writers of this new psychological school have done excellent service in emphasizing social institutions and the interrelation of ethical, political, and economic values; but they seem to forget that this emphasis can be accomplished without regarding society as an organism. While criticising economists for taking individual activities as ultimate data,[1] they are themselves too prone to take social institutions, fashions, social values, society itself, for granted, and so to dismiss the question of priority of individual and society as unimportant, forgetting that what is unimportant in *time* may in *logic* involve the true social point of view.

There remain at least two other theories of society which are worthy of more serious attention. The first of these may be called:

(3) The common-content-of-consciousness theory, or for short the *common-consciousness* theory. Passing over the sub-varieties of this theory for the present, we note first that it comes nearer to being a rational theory than either of those mentioned above; for it does not rest upon an assumed natural condition, individual or organic. According to it, society, — which is thought of as having always existed where men have had relations with one another, — is the

[1] Cooley, "The Institutional Character of Pecuniary Valuation," American Journal of Sociology, January, 1913.

necessary and normal result of an evolutionary process, whereby certain instincts arise and are molded so as to lead men to take on such relations as constitute society. Society, then, is regarded not as something separate from the individual, but as the summation of those parts of individual consciousnesses which are alike. Such phases of individual consciousness are embraced in social life as are the result of a common experience and inheritance. Society thus arises naturally from, and is limited by, the fact of a common content of consciousness. Perhaps this concept is illustrated best by the thought of those members of the historical school who have held to what is, after all, a rather mechanical idea of development; for a little reflection shows one that it considers the individual as an exclusive fragment bound to other individual fragments by a chance similarity and not by any interpenetrating consciousness of that similarity. After all, according to this theory, the social point of view means a sort of average of mechanically related units, — human units, but still an average. Therefore, if it is to be applied to present-day civilization, it is open in some degree to the same criticism as the preceding theories on the score of virtually overlooking the differences among individuals.

Two degrees of this common-consciousness theory may be distinguished. (*a*) Apparently some thinkers go no further than to regard society as merely built up of individuals. The individuals are thought of as absolute and ultimate bundles of innate instincts. Those who, consciously or unconsciously, have this conception would logically think of social demand as a mere sum of individual demands, and would freely add and average in a mechanical, arithmetic way. (*b*) But others, while holding a similar idea of the origin

of society, would evidently attach more positive significance to its existence. They would regard society as reacting upon the individuals who compose it, conditioning them and molding their states of consciousness. Thus, social demand would express, in part, the reaction of the social relationship upon the content of the individual's consciousness. It is the latter variety which lays such emphasis upon imitation. Social leaders suggest styles, fashions, customs, which the individual is thought of as more or less blindly following. Without being conscious of the nature of his relations to society, the individual is positively affected thereby, through his ability to sell to others and his desire for their esteem. I believe that most economists of the present day tacitly assume a "society" of this latter type.

(4) Finally, we come to the *conscious-commonness* theory, so to call it. One who holds this theory will see the origin of society in the reflective consciousness of the individuals concerned, — a consciousness which embraces the fact of a commonness of the contents of the various individual consciousnesses. Instead of regarding the individual as a mere mechanical fragment of consciousness, one will think of him as being conscious of his interrelations with his fellows, and so doubly bound to them. Society and the individual, far from being separate, will be inseparable aspects of a complex whole, neither one coming first nor standing above the other; but, through the conscious interaction of individuals, the one will be seen in the many, and the many in the one. Thus, this theory contains the element of truth found in the social-organism theory.

It follows that differences among individuals — whether innate differences in efficiency or acquired

differences in wealth — are recognized. Not only are they not overlooked, but they are not avoided by any mathematical jugglery, for the way is seen to lie open for a conscious adjustment of necessary differences. Society means co-ordination, — harmonious adjustment. Not an average; not the fusion; not the identity; but the co-operation of individuals makes society. Consequently, individual self-interest and social interest are capable of being harmonized; for, if we assume intelligence, it is clear that each member of society, being conscious (*a*) of his relations to others, and perhaps (*b*) of their similar consciousness of their relations to him, must recognize the interdependence of their common interests, and understand that the maximum of well-being is to be gained by co-operation with his fellows.

The conscious-commonness theory makes the scope of society depend, not upon mere blind common content derived more or less passively from common environment, but upon mutual consciousness of that commonness of content. It makes social life include such phases of individual consciousness as are consciously held in common. It follows that society, so defined, may be in one way narrower than the preceding concept, while in another way it may be broader. This is true, first, because the number of individuals who are capable of appreciating their interrelations with others is more limited; and, second, because the number is not, on the other hand, restricted by the character of experience and environment. On the contrary, by means of education and interchange of ideas, all sorts of individuals from all sorts of environments may be embraced in a community of consciously common ideas.

As in the case of the " common-consciousness theory," two degrees of the conscious-commonness theory may

be distinguished. (1) Some may regard the members of society as merely conscious of the existence of like *ideas* in the minds of their fellows; (2) others may go further, and make society depend upon a consciousness of like *interests and purposes*, and a consciousness not merely that those like interests and purposes exist but that each one is conscious that every other is aware of his interests and purposes. The first degree, obviously, is less positive, and leads to the concept of a less active society. Society is thought of as merely conditioning and molding individuals. The second degree, however, is that of a positively active society, in which the existence of a mutual reflective consciousness of common feelings, beliefs, and desires becomes a moving force, leading to active co-operation. Thus, we may call this higher degree of the consciousness-commonness idea the "*conscious-co-operation*" theory.

As held by some philosophical, neo-classical, and eclectic economists, this idea of society finds expression, for instance, in an ability to harmonize government interference with individual initiative, — social control with private property. Likewise, competition is neither praised nor blamed, but given a more or less limited place according to its workings. And the law of diminishing productivity is strictly confined to a non-historical application, for it is realized that by intelligent co-operation constant progress may rationally be assumed.

To suggest somewhat more of the economic significance of the last two main concepts of society, it may be said that, according to both, the social point of view as to valuation means a balancing of individual marginal utilities and disutilities. No such thing as margin of utility for society is recognized; but it is clearly seen that, to some extent, the fact of social rela-

tionships reacts upon individual marginal utilities. Social policy is to be determined by a summation of interrelated and mutually influenced individual valuations. The two concepts differ in that according to the one the individual is not rationally aware of this balancing process, being blindly led by instinct or imitation, while according to the other each is aware. Consequently the latter means a much closer and more plastic relationship among the marginal utilities of individuals.

There are, then, four general ways of looking at society. Of these, the two first mentioned may be discarded as unsound. The last two, together with their various shades or degrees of difference, contain within themselves the true concept. When one asks which of these is the true one, and which the true subvariety, I think one must recognize an element of truth in each. Is it not a mere question of fact? The lowest forms of society are instinctive, like the colonies of ants and bees. The highest forms are based upon an intelligent consciousness of common interests, as in the highest development of human group life. Between the two lie the stages of an evolution. Of these stages I have but indicated four: —

| | | |
|---|---|---|
| I. Common consciousness | 1. | Common instincts. |
| | 2. | Imitative commonness. |
| II. Conscious commonness | 3. | Consciousness of common ideas. |
| | 4. | Conscious co-operation. |

Thus the question as to what concept of society should be involved in the economist's "social point of view" depends upon the facts as to the kind of society to which his thought applies. If the group concerned is of a low order of development, innate instincts and emotions (gregarious, parental, reproductive, acquisitive, of display) are the dominant forces. If the stage of "mob action" exists, a stage

in which leaders are the great forces, and imitation (a complex group of instincts?) is the prominent factor, we still have a low order of society. If the society, however, is one in which each is conscious of a common mass of ideas, sentiments, and beliefs, we have a distinctly higher order of relationships; and when this consciousness embraces a realization of common interests and purposes, the highest stage is attained, in which the social point of view means a large measure of direct and conscious co-operation.[1]

As a matter of fact the highest societies known today involve no small element of instinctive action; that is, our real individuals are in part creatures of instinct. Education is covering over the instinct basis gradually, the result being a highly complex mass of motives and sanctions. If existing society were based solely upon instinct or solely upon conscious co-operation, the analysis of the social sciences would be vastly simplified, and we could make economics an exact science. As it is, motives are so mixed and divergent — some being instinctive, others rational — that when we seek to make any ultimate analysis we are either prevented, or, by abstraction, reason on the assumption of some one of the single concepts indicated above.

### 2. *The Application of the concept of Society*

As if the foregoing were not complicated enough, one soon finds in the definition and use of economic terms at least two ways of applying the various concepts of society. (1) Thus, one writer, whichever one of the four concepts he may choose, in applying the social point of view may mean the point of view of a

[1] It may be interesting to note that in the first stages, individualism, materialism, a negative concept of society, and the idea of a necessary clash of interests, all are logical; and these ideas characterise the thought of those whose social point of view means society in those stages. But each higher stage is a limitation upon individualism and materialism, and a step toward a more positive concept of society.

society *as a whole*, — a sort of anthropomorphic concept of society. He thinks of society and individuals as separate entities, and his individual — and he himself — takes a social point of view through a feat of altruistic gymnastics called self sacrifice. This, as Spencer puts it, involves "a combined action which directly seeks and subserves the welfare of the society as a whole, and indirectly subserves the welfare of individuals by protecting the society." [1] Such a writer, it is clear, has in mind the *aggregate* wealth or activity of the group as a whole. Looking at society in this way, he is apt to think of it as occupying a certain territorial area. Often he really means a given nation, thus falling into the old error of confusing "society" with the "state." He comes to deal with the "wealth of nations" literally, and hopelessly confuses economics and politics.

(2) But another writer, in using the words "social point of view," may mean something quite different, namely *a relation among the individuals* who compose the group, be it society or nation. He means, not the aggregate wealth of the whole group, but wealth considered from the point of view of an individual who conforms to the group's standards, — who is an integral part of the society.

Thus, the one application does not concern the individual directly, and considers an aggregate; the other starts with the individual, but limits or modifies his motives and possessions by putting him into a complex of social relations. Nor, in the latter application, are the welfare of the individual and the welfare of the society separated.

I am inclined to believe that a good deal of confusion has crept into economic reasoning as a result of failing to distinguish these two possible uses of the idea of

[1] Spencer, Principles of Sociology, vol. ii, p. 247 (N.Y., 1891).

"social"; and that possibly a consistent resort to the latter use will open the way for a more sane and lifelike treatment of economic problems. According to it, "from the social point of view" would mean from the point of view of an individual who, being sensible of a likeness between the content of his consciousness and that of the consciousnesses of his fellows, acts in accord with that sensibility. Or, put more objectively, the social point of view is the point of view of *an individual who, being conscious of a mass of feelings, beliefs, and purposes which he shares with those with whom he comes in contact, acts in such a way as to preserve society.* Put either way, the idea is the same: things are seen through the eyes of a sentient and conscious *individual who is aware of an interdependence among the members of his group, including himself, and consequently, to some extent, co-operates with them.* What acts are to be excluded is not necessary to decide here. The question must be more or less relative. Suffice it to say that, if we take the broad stand of society in general, all activities which violate the morals, laws, or economy of a society tend to destroy society, and are anti-social; a social individual would not engage in such, and consequently they are not in accord with a social point of view. Two things are certain: (1) One cannot escape the simple fact that only the individual can experience costs and utilities and make valuations, for he alone is the seat of a nervous system and sensations. (2) The individual is a product of heredity and environment, and through both he is molded by those relations with his fellows which we call social. In view of these facts, the only logical recourse seems to be to look at economic facts and forces through the eyes of an individual considered as an integral part of a society, — the "social individual." This would free us both from atomistic

individualism and from organismic societism. The one-sidedness of both individualism and socialism becomes apparent. The conclusion, then, is that for most purposes we should adopt what may be called "*the social-individual point of view.*"

As already implied, the "social individual" may be thought of as a member of any kind of society, and the social-individual point of view is, therefore, but a means of applying one's concept of society, that concept being the primary consideration. Thus, to take but a single case, if one takes the "conscious-commonness" theory, one's social individual is always thought of as a person who is more or less intelligently conscious of the ideas of his fellows, and is far removed from being a mechanical fragment or atom. He is always a part of society in the sense that he so acts upon and is reacted upon by his fellows that all are interdependent, and he knows it. Nothing is assumed as to his equality with them, nor as to his natural position in a social organism. He values things in view of his relations to others. He may be more or less selfish — as the psychologist may decide — but by the economist his wealth-getting-and-using activities are taken for granted so long as they are consistent with a consciousness of the existence of similarly conscious fellows.

From the social-individual point of view, predatory and other anti-social activities not being recognized, the Peruna and burglar's-jimmy problems would be quickly and correctly solved. They would hardly be problems! Of course, "wealth" would be somewhat narrower in scope than the non-social individual might wish. On the other hand, merely acquisitive activities would be given a logical recognition: if based upon free exchange, the social individual's activities may add to his wealth without adding to that of his fellows. Does

he not thereby gain for the efficient at the expense of the inefficient, even tho the "wealth-of-society-as-a-whole" is not increased?

## III. The Special Meaning of the Social Point of View in Economics

But after one has taken any of the four ideas of society, and has decided whether to look at things from the point of view of a society as a whole, or that of a "social individual," the question remains, how much of society should one include? What should be the content of one's social point of view? Is the social individual to be the "economic man"? Not only do we generally reason more or less abstractly by assuming, consciously or unconsciously, some one of the various concepts of society; but we also usually are forced to make our reasoning still more abstract by limiting the content of the idea of society. We do this by considering only a part — or, better, an aspect — of the content of individual consciousness which is held in common.

Social life, of course, has many modes; and there are many centers of conscious activity which, as it were, form the points of contact between the consciousnesses of those individuals who form a society. The more of these centers that are thought of as embraced in the common consciousness, the richer the concept of society, tho probably the fewer the individuals included. To be more concrete, we often speak of various "worlds" such as the "literary world," "the world of art," "the world of business." Then there are "racial ties," "social whirls," and the like. Common language, racial temperament, religion, and the like, tho not essential, facilitate the formation and existence of these societies. Perhaps the most important of the social "worlds" center in religion, ethics, economics,

government, and art, using these terms very broadly. Accordingly, the social point of view might be based upon a society including all these worlds, or aspects of consciousness, so that its members would act and react effectively upon one another from many angles. This would be the broadest social point of view, — the one for "sociology." Should it be taken by the economist? Here we meet a question akin to the old one concerning the inclusion of ethical and political considerations in economic analysis.

It seems clear that the economist's social point of view should include only the economic aspect of society. For the same reason that "utility" and "wealth" are generally regarded as non-ethical concepts, the economist, as such, should be limited by a wise division of labor to that aspect of the common content of individual consciousnesses which concerns men's relations to things of limited supply that they desire. Just as economics is concerned only with those individual acts that concern wealth (including services), so its social point of view posits an economic society.

An economic society may be defined as a group of individuals who are mutually dependent upon a common or interrelated supply of economic goods. If it is as highly developed as are most economic societies today, it becomes a group bound together by mutual consciousness of the desirability of exchange, and is based upon a conscious appreciation of the importance of the interrelation as a means of gratifying the wants of the individuals concerned. It thus ceases to be based upon a quasi-mechanical exchange of goods.

Such a society may or may not coincide with a "world of art" or a "race." It is not confined to national bounds. Indeed, it may be narrower in extent than a nation. Are not England and the United States and Canada embraced in a single economic

society? And was the South in 1860 not more a part of England's economic society than of that of the North? Probably dreams of universal peace will come most nearly being realized as a result of the growth of a highly developed world-wide economic society, — an international consciousness of common economic interests.

Thus, to take a special case, wealth, from a truly economic social point of view, should be defined without regard to the artist's, the statesman's, or the prophet's official valuations. Obviously, there can be many different attitudes towards the things that the economist calls wealth. Wealth exists as an objective fact; but each social science approaches it from a different angle of vision, and, while to the student of ethics it is one of many "good" or "bad" things, and to the statesman one of many means to the end of the security and political well-being of the citizen, to the economist it is the whole external world of scarce, want-gratifying things. To be sure, he must know that men desire certain scarce things partly because they think them right or politically expedient, which, put in other words, is to say that the economic world — being a part of other worlds, all interpenetrating — is modified in scope by those other worlds; but he takes his world as he finds it, and his society is none the less economic. Thus, his social point of view does not mean an ethical one, even tho the influence of ethics is not to be excluded.

This does not mean that the economic society is peopled with mythical "economic men"; but it does mean that the economist's society is that aspect of society or societies taken as a whole which centers in economic relations, and that ethical or other motives are of interest to him only as posited data which may aid him in understanding the course of men's wealth-

getting-and-using *activities*. It may, however, be said to mean a true economic man in the shape of an economically social individual who lives in accord with the mutual dependence and consciousness of the desirability of exchange which characterize the economic aspect of society, — the economic world.

In fine, I conclude that the true meaning of the social point of view, as most expedient for the economist, is as follows: it is the point of view of an individual who is conscious of an interdependence among those with whom he comes in contact relative to all scarce utilities, and who consequently acts so as to co-operate with them in producing and consuming such utilities. It is the point of view from which the individual is seen as the conscious unit of a group whose members are interrelated by commonness of content of consciousness with regard to wealth. Proceeding from the individual consciousness, the economist's social point of view concerns a relationship among individuals based upon exchange. Society and individual are synthesized. This I have called the social-individual point of view.

Whether convinced of the soundness and expediency of the foregoing conclusions or not, the reader can hardly fail to admit that a true social point of view for economics must be founded upon (1) a true concept of society in general, (2) a true concept of "social," as involving the application of the concept of society, and (3) a true concept of "economic society" in particular. It is the writer's earnest desire to see such concepts adopted and consistently followed by economists.

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# THE KARTELL MOVEMENT IN THE GERMAN POTASH INDUSTRY[1]


## SUMMARY

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## I. INTRODUCTORY

THE actual source of the world's potash supply is at present in the deposits of potash salts found in northern Germany. The great Stassfurt potash industry is based on the presence of those salts in the

[1] Among recent publications on the subject, the following have been especially helpful:

Krische, Dr. Paul, "Die Verwertung des Kalis," in Industrie und Landwirtschaft, 1908.

Stange, Dr. A., Fünfzig Jahre Deutschlands Kali-industrie, Jubilaeumsschrift, 1911.

Paxmann, H., Die Kali-industrie in ihrer Bedeutung und Entwicklung, 1899.

Pfeiffer, E., Handbuch der Kali-industrie, 1887.

Passow, Dr., Materialen des wirtschaftlichen Studiums, bd. ii.

Groth, L. A., The Potash Salts, 1902.

so-called Magdeburg-Halberstadt rock salt basin.[1] Smaller and commercially unimportant are the deposits of the same type found in Galicia, Chili, Persia, and Eastern Asia. Germany thus possesses a practically complete monopoly of potash salts. Their solubility and the ease with which they can be converted into concentrated products are the qualities which have made the world envious of Germany's possession of this great resource.[2]

The story of the discovery and development of these deposits is interesting. For hundreds of years salt springs had attracted attention in the Stassfurt region. At length, after a number of unsuccessful attempts in the decade 1850 to 1860, rock salt was discovered after penetrating several strata of peculiar bitter salts. The salts designated "Abraumsalze," were regarded as worthless, — an obstruction to the mining of rock salt. Professor Marchand showed that they contained certain valuable elements, whereupon the Prussian government started to sink a shaft in 1858 for the purpose of mining them. Small quantities of the crude salts were subjected to a process of concentration and sold for industrial uses. The success which attended the opening of the Prussian mine induced the Grand

Schulze, H., Die Chemische Industrie in Deutschland, 1908.
Schönemann, Die deutsche Kali-industrie und das Kaligesetz, 1911.
Heimann, R., "Die neuere Entwicklung der Kali-industrie und des Kalisyndikats," in Schmoller's Jahrbuch, 1906.
Engelke, G., Das deutsche Kalikartell in seiner Entwicklung und gegenwärtigen Gestalt. Schriften des Vereins für Sozialpolitik, bd. ix, 1894.

Valuable material is found also in the Kartell-Rundschau (since 1903); the Kartell-Jahrbuch (bd. i, ii); the Berliner Jahrbücher für Handel und Industrie (published by the Aeltesten der Kaufmannschaft, since 1903); the Deutsche Oekonomist; and the Drucksachen des deutschen Reichstages.

[1] See brief description in Engelke (p. 45), Heimann (p. 1489), and in the books of Krische, Paxmann, and Pfeiffer. I refer to these sources also for the historical sketch that follows.

[2] On the various endeavors, all virtually unsuccessful, to find sources of potash supply in the United States, see Fertiliser Resources of the United States, prepared by the U. S. Department of Agriculture and published as Senate Document 190, 62d Congress, 2d Session (1912).

Duchy of Anhalt to open a second one, which began operations in 1862. But the value of the "Abraumsalze" was immensely enhanced when, after a series of painstaking investigations, Dr. Frank, assisted by Justus von Liebig, demonstrated their value for fertilizing purposes. These discoveries inaugurated a new era for the Stassfurt industry, which now, by reason of its lower cost of production, possessed a great advantage over other sources of potash. The price of muriate of potash, which ranged from $75 to $100 per metric ton in 1862, fell to one-third that price in 1864 and 1865.

At present only the potash salts with the highest potash content are mined. Of these, the most important are carnallite, kainite, hard salts, and sylvin. Carnallite is a hydrated double salt of muriate of potash and magnesium chloride, used especially as the basic salt for concentration into muriate of potash. Kainite is also a double salt containing potash in the form of sulphates and chlorides of potash mixed with sulphates and chlorides of magnesium. It is more valuable than carnallite and can be used directly as a fertilizer. Hard salts are a mixture of kieserite and kainite with sylvin. Sylvin is the most valuable of all the crude salts. Like hard salts it finds its chief employment in industry, while kainite is used chiefly in agriculture.

In the export trade the concentrated salts play a much more important part than the crude salts. Muriate of potash (KCl) is the most important, being used in immense quantities as a fertilizer for sugar beet, cotton, and other crops. Sulphate of potash ($K_4SO_2$) is manufactured in smaller quantities, of which a large part is absorbed by tobacco culture in the United States. Such potash products as carbonate of potash, manure salts, and the crude salts, bergkieserit, sylvinite, schönite, are of less importance.

The annual output of the German potash industry shows an extraordinary increase during the past half century, as is indicated by the following table: —

OUTPUT OF POTASH SALTS[1]

| | In 1000 Metric Tons | Value in 1000 Marks |
|---|---|---|
| 1862. . . . . | 19.8 | 340 |
| 1870. . . . . | 291.9 | 2,628 |
| 1880. . . . . | 665.9 | 6,783 |
| 1890. . . . . | 1274.9 | 16,500 |
| 1900. . . . . | 3050.6 | 39,111 |
| 1905. . . . . | 5043.5 | 60,391 |
| 1909. . . . . | 7042.0 | 81,655 |

The production of muriate of potash also shows large increases. A significant change in the demand appears in the fact that, whereas in 1861 no potash was sold for agricultural purposes, by 1880 agriculture took 42.5 per cent of the total output and in 1905, 84.5 per cent. Altho the consumption of potash in the glass, soap, and other industries has increased in absolute amounts from year to year, it forms relatively a steadily diminishing portion.[2]

The United States is the largest consumer of potash outside of Germany itself. The increase in the importation of potash during the past twenty-five years has been marked. Owing to the frequent changes in classification it is difficult to obtain a comparable set of figures; but for muriate of potash, the most important of the products imported, the increase since 1884 has been nearly ten-fold.[3] Sulphate of potash and manure salts show a slower but still significant growth.

[1] Compiled by Schönemann from Vierteljahrshefte zur Statistik des Deutschen Reiches.

[2] New York Financial and Commercial Chronicle, vol. xc, p. 630, contains an interesting note in this connection.

[3] Value, 1884, $729,484; 1912, $7,229,109.

Nevertheless, the American consumption per acre of tillable land is as yet only one-eighth of the consumption in Germany. Three-fourths of the potash imported into the United States is used in the Atlantic and South Central states, in the form of commercial fertilizer, of which potash is a constituent.[1]

The potash trade in the United States is handled by the New York agency of the potash syndicate. Several groups of buyers may be distinguished.[2] First, the powerful fertilizer manufacturing corporations, of which the largest are the American Agricultural Chemical Co., of New York, and the Virginia-Carolina Chemical Co., of Richmond, both organized in the late nineties as combinations of existing fertilizer concerns. To these was added, in 1909, the International Agricultural Corporation, a result of the developments of 1906–09, which led the so-called independents to combine.[3] The Virginia company owns a controlling interest in the Einigkeit potash mine in Germany, while up to the end of 1912, the International owned the Sollstedt mine. A second group of potash buyers is formed by the large packing houses, which buy potash for their fertilizer plants, and the smaller independent fertilizer manufacturers. Finally there are manufacturers of chemicals, dry mixers and jobbers of fertilizer, farmers' associations, and local dealers.

[1] Cf. 12th Census, vol. v, p. cxxxix; Krische, pp. 154–157; Stange, pp. 154–155.

[2] Kartell-Rundschau, vol. ix, p. 83.

[3] For a history of the attempts which preceded, consult American Fertilizer, April, 1909; and July, 1909, p. 23.

## II. Early Agreements. The First Syndicate (1889–1898) [1]

Following the entry of the two fiscal potash mines into the field of potash production, the factories established by private individuals for the manufacture and concentration of the crude salts began in 1864 and 1865 to outstrip the capacity of the market to absorb their products. The number of enterprises had increased from three in 1862, to eleven in 1863 and eighteen in 1865. Commercial depression and over-production resulted in the failure of nearly a third of the companies in the latter year. Rapid recovery and subsequent prosperity again brought about, in 1871 and 1872, an increase of manufacturing facilities not warranted by demand. The decline in the price of muriate of potash which began in 1872, and lasted until 1874, put a number of factories out of business.[2] The pressure toward some sort of combination led to an agreement between the manufacturers in 1876, whereby prices were to be fixed weekly by a commission. With the resumption of prosperity in the following year, several of the members withdrew and the agreement came to an end.

In contrast, the development of the potash mines up to 1875 was one of steady progress.[3] But in that year, a third mine at Westeregeln, and a fourth, New-Stassfurt, in 1877, deprived the fiscal mines of Prussia and Anhalt of their monopoly in the production of crude salts. In view of the fact that any one of the four mines could, if necessary, supply the total demand, the

[1] In addition to the works already cited reference may be made to the Denkschrift über das Kartellwesen, bd. i, 1905, p. 77. The Kartell-Rundschau has given, since 1903, an account of current events in the potash syndicate.

[2] Pfeiffer, pp. 105 et seq.; Krische, p. 79.

[3] Paxmann, pp. 36 et seq.; Krische, pp. 79 et seq.

fiscal mines did not relish the idea of unrestrained competition. The expected happened. The alternative of free competition and low prices, sure to entail serious losses upon all of the mines, and eventually ruin to some, was rejected for combination. With the active coöperation of the Prussian fisc, the four mines, Stassfurt (Prussian fisc), Leopoldshall (Anhalt fisc), New-Stassfurt and Westeregeln, agreed to limit for five years the output of carnallite intended for concentration into refined salts.[1] Certain provisions as to the price of crude salts were included, but it was left open to the factories to fix the prices for concentrated products.[2] Between the three kainite producing mines a similar agreement was concluded in April, 1879, fixing prices and the total amount to be mined by each member.[3]

The success of the potash mines was an incentive to the investment of capital in new enterprises of the same sort. A mine at Aschersleben began operations in 1882, and threatened to rob those already in the field of their market. Westeregeln's notice in June, 1883, of withdrawal from the carnallite agreement led to its dissolution in October. However, after some negotiation efforts at securing a new agreement were successful, and on October 21, 1883, representatives of the five mines signed contracts renewing the previous one. As the Aschersleben mine also produced kainite, the necessary revision of the kainite agreement was made and Aschersleben became a member in 1884.[4]

[1] Also Engelke, p. 7.

[2] The proportion of the total output allotted to each mine was as follows:

| | |
|---|---|
| Prussian Fisc | 50 % |
| Anhalt Fisc | 27.5% |
| New-Stassfurt | 10 % |
| Westeregeln | 12.5% |

(Krische, p. 79.)

[3] Krische, p. 80; Schönemann, p. 6.

[4] Schönemann, pp. 6, 7; Krische, p. 80; Engelke, p. 9.

At the time a seventh mine, Hercynia at Vienenburg, became a party to the carnallite agreement, several changes were made. Special privileges, that of fixing the price of crude salts sold to the factories, and the right to veto a reduction or increase in allotments, were conceded to the Prussian government. The price-fixing privilege was of small importance except to the fiscal mines, since the private mines supplied only their own factories operated in connection with the mines.[1]

Shortly after the renewal of the carnallite agreement in 1883, the manufacturers of muriate of potash formed an association for marketing concentrated products.[2] As the supply of raw material was fixed by the mine owners, no restriction of production was necessary. The organization, somewhat more elaborate than in previous agreements, provided for a central sales office through which all the manufacturers agreed to market their products. The manager of the sales office, acting according to instructions formulated by a representative commission of manufacturers, effected sales, received orders, and assigned them to the members as nearly as possible in proportion to the quantities of raw material assigned to them by the mine owners' association. Occasional excesses or deficits were to be adjusted semi-annually. The commission fixed the price of muriate of potash, but could raise it only with the consent of the Prussian fisc.

The potash industry prospered during the decade following the formation of the first agreement. The combination, including as it did all the producers, had been able to keep up prices and, at the same time, increase the demand for potash. The addition of three new mines had not been a disturbing factor. The

[1] Engelke, pp. 8–10.

[2] Schönemann, p. 7; Krische, p. 80; Engelke, p. 9.

advantages of regulation had become too evident to allow a return of free competition upon the expiration of existing agreements. Strengthened by observation of the results of competition which had taken place between the pooled and independent muriate factories in the American market, the opinion became prevalent that a renewal of existing contracts was insufficient and that all products, crude and refined, should be included in a new and firmer agreement. Finally there was formed, during September and October, 1888, the first all-embracing potash Kartell or syndicate, upon the basis of seven separate contracts or agreements, the first four of which related to crude salts, the last three to refined products.[1]

The members of the syndicate proper were mine owners exclusively. Owners of special factories (*i. e.* factories not operated in connection with any particular mine) who were members of the muriate agreement of 1883, were compelled to observe the conditions prescribed in the last three contracts as to the production and sale of concentrated products. In return, they were assured an exclusive supply of raw material for the greater part of the syndicate's duration of ten years, with the warning that they would be cut off from all supplies if they were found to encourage the establishment of a new potash mine. The output of the special factories had been steadily decreasing, and when the Prussian fisc, which had operated no factory of its own, withdrew formally from the existing agreements to establish a factory in 1887, the business of the special factories had decreased to such an extent that they offered to pay the Anhalt fisc higher than current prices in order to secure crude salts. Consequently in 1888, the assurance of raw material was welcome to them.

[1] For a description of the contracts, see Krische, p. 81; Schönemann, p. 7; Engelke, pp. 12, 13.

The first two of the seven contracts (designated I*a* and II*a*) dealt with carnallite. A commission of representatives from the seven mines fixed the total amount to be mined and allotted it by percentage shares to the individual mines.[1] Minor provisions regulated the raising and lowering of quotas. Kainite containing 12.4% pure potash was chosen as a basis for the calculation of allotments. The kainite contracts (II*a* and II*b*) dealt similarly with the allotment of production, but since kainite, unlike carnallite, is sold in its crude state for agricultural purposes, its sale was placed in the charge of a central sales office, the producers agreeing to make no independent sales, to observe the terms of sale fixed by the central office, and to make regular and accurate reports. Selling prices were fixed by a committee of the associated mine owners, subject, however, to certain privileges conceded to the Prussian Minister of Commerce and Industry. He was given the right to name special prices for the supply used in domestic agriculture, whenever it should seem advisable in order to increase sales, or necessary for the welfare of German agriculture. The detailed provisions for the temporary transfer of allotments during disturbances in operation need not be mentioned here.

The last three contracts (I*c*, I*d*, II*c*) had substantially the same aim as the others, — the elimination of competition and the prevention of over-production. The special factories together with the factories of the mine owners were all subjected to the restrictions of a central

[1] The allotment in 1888 stood as follows: — (Schönemann p. 7).

| | |
|---|---|
| Staassfurt | 18 13/15% |
| Aschersleben | 14 8/15% |
| Hercynia | 7 3/15% |
| Leopoldshall | 14 8/15% |
| Westeregeln | 14 8/15% |
| New-Staassfurt | 14 8/15% |
| Ludwig II | 10 12/15% |

sales agency, the orders being assigned and adjustments made as under former agreements. Prices and rebates were fixed by a general commission which was also empowered to dispose of quantities of muriate of potash, at specially low prices, or gratis, for propaganda purposes to chemists for experiment, for exhibitions, for the support of agricultural trade papers and the like. This was the beginning of a type of endeavor which has been most effective.

Since the administration of each of the basic agreements was in the charge of a separate committee, the management proved so unwieldy as to necessitate a reorganization in 1891. A centralized administration was introduced.[1] The general management, of which the representative of the Prussian fiscal mine was *ex officio* chairman, obtained broader powers; while a general commission, consisting of one representative from each mine, performed the duties of the several committees under the old arrangement, fixing prices, deciding important questions of organization and distribution, and imposing penalties for breach of contract. The general or business management was divided into three departments, each headed by an assistant director. One of these took charge of the domestic business and the transactions between the syndicate and the individual mines; another took the export trade; and the third, the statistical work and the propaganda movement. As before, orders were received and assigned and adjustments made at the central offices. The syndicate, which now styled itself "Verkaufssyndikat zu Leopoldshall-Stassfurt," established agencies in several German and foreign cities, while in others it gave certain dealers exclusive control. Up to 1893, the American trade had been controlled by two exclusive

[1] Schönemann, p. 9; Engelke, pp. 2 et seq.

dealers, but the syndicate's dissatisfaction with the growth of the American demand under their direction led to the establishment of a special agency in New York.[1]

During this syndicate period (1888–98) five new mines became members of the syndicate.[2] The fever of speculation from 1895 to 1898 did not pass the potash industry by. It is said that over a hundred boring companies were in operation and many shafts were sunk. The failure of not a few companies, and the depression at the close of the decade, led to the abandonment of many of the enterprises.[3] But in general the syndicate succeeded in increasing the sales of potash and in steadying the market. Tho it was not able to avoid over-production entirely during the difficult years, 1892–93, it prevented the industry from experiencing the worst effects. On the ground that the existing facilities were too large, the Prussian government advocated a restriction upon the establishment of new mines. The policy of restriction did not appeal to the legislature at that time. The debate on the 18th and 19th of April, 1894, in the Abgeordnetenhaus, was concerned chiefly with the question of whether or not the Prussian fisc would have influence enough, should restriction be adopted, to secure lower prices for domestic industry and agriculture; it ended with the rejection of a proposed law.

## III. The Second and Third Syndicates (1898–1904)

As might be expected, little opposition developed when the question of the continuance of the syndicate

[1] Engelke, p. 24.

[2] Krische, p. 84.

[3] The Mineral Industry, vol. vii, p. 571.

came up for decision in 1898. The agreement of that year differed from the preceding one in that a single comprehensive contract took the place of seven. The products were divided into four groups according to their potash content. The management of the syndicate was given greater freedom and authority by the adoption of the stock company form. Instead of a commission consisting of a representative from each mine, a supervisory council of fewer members was created. During the three year existence of the second syndicate, five mines were added to the membership.

Again, in 1901, renewal of the syndicate upon substantially the same basis as in 1898 was effected without difficulty. The opposition which was manifested concerned mainly the question of the admission of new mines into the syndicate. It was becoming apparent that the number of mines was increasing more rapidly than it was possible for the syndicate to increase sales.[1]

After 1901, however, the situation became serious. The depression of 1901 and 1902 resulted in a decrease of the syndicate's business, the effects of which were accentuated by the entrance of new mines.[2] From seven mines in 1888 and twelve in 1898, the number of producing mines had risen to twenty-four in 1902 and twenty-eight in 1903. The necessity of bringing all these into the syndicate, the unwillingness of the older mines to give up any part of their allotments in order to make room for new members, and the high demands of prospective members rendered the allocation of quotas a progressively difficult task. The market from 1902 to 1904 was unsettled. Both dealers and consumers

[1] Cf. article by Dr. Kreusham, Kartell-Rundschau, vol. ix, pp. 1 et seq.; also Krische, pp. 47–52.

[2] Kölnische Zeitung, Dec. 20, 1902, quoted K. R., vol. i, p. 53; and K. R., vol. i, pp. 724–725.

delayed buying, toward the last, in the hope of obtaining lower prices in the event of the dissolution of the syndicate.

## IV. The Syndicate of 1904–1909

Early in 1903, dealings of American potash purchasers with some of the newer mines which had not yet entered the syndicate gave rise to rumors, every disturbing to Germans, that the Americans intended to buy up potash properties and supply their own demands.[1] The subsequent entry of these mines into the syndicate quieted the fears for a short time, only to be again aroused by the report that the Virginia-Carolina Chemical Company was attempting through the Heldburg Company to obtain control of the Wintershall mine, in addition to its ownership of a controlling interest in the Einigkeit mine.[2] Tho this report was denounced as false it caused much resentment. It was said that the loss of the American market, which amounted to one-half of the total export trade, would be a calamity to the industry as well as lead to wanton dissipation of the natural resource.

At the instance of the Prussian fisc, negotiations aiming at the continuance of the syndicate, which expired in 1904, were taken up early, the first general meeting being called for May 8, 1903.[3] This early action, hastened it is said by the reports of the American "invasion," recognized that the renewal would not be effected as easily as on previous occasions. Altho the syndicate included all the operating mines (after the entrance of the mines Hohenfels, Kaiserroda, Einigkeit,

[1] Hannover Anzeiger quoted K.R., vol. i, p. 487.

[2] lxxv Chron. 81; lxxvi Chron. 1038.

[3] Berliner Jahrbücher, bd. i, 1904, p. 10.

and Bleicheroda, in January, 1903) this complete control was of short duration. Moreover the internal composition of the syndicate had been undergoing a change by the division of the members into two hostile groups, one composed of the older mines having comparatively large quotas and unwilling to submit to the decreases attendant upon the increase of syndicate membership, and the other made up of newer mines demanding larger quotas in some proportion to their alleged capacities.[1] According to a clause in the existing agreement, syndicate members were free after June 30, 1904, if renewal had not been accomplished by that date, to execute independent contracts for delivery after December 31, 1904. Consequently, all efforts were directed toward effecting a renewal by July 1, 1904, in order to avoid the complications which would inevitably arise should independent contracts be made.

At the general meeting, May 8, 1903, it was voted that the continuance of the syndicate was desirable and that the invasion of American capital must by all means be prevented. Two committees were chosen, one to discuss the draft of a new agreement, the other to take up the allotment question.[2] Following the admission of three new mines into the syndicate, the general meeting on November 3 took up the discussion of the proposed basis for renewal.[3] It was soon discovered that the chief point of dispute was the allotment question. A special committee, instructed to report at the next general meeting, was chosen to attempt to induce the various mines to agree to a compromise table of divisions. The committee found it impossible to accomplish anything. No less than eighteen out of

[1] Berliner Jahrbücher, 1904, p. 111.

[2] K. R., vol. i, p. 566.

[3] K. R., vol. i, p. 1121.

twenty-eight mines raised objections to a table of allotments submitted for inspection in November.

The second general meeting of syndicate [1] members on January 18, 1904, showed a sharp division on the allotment question between the two groups of mines.[2] The group of older mines declared it would not submit to any further reduction of allotments and demanded that the younger mines agree among themselves as to the division of the balance of the total output. The latter elected a committee to consider the matter, but the high demands of certain mines precluded a settlement.[3] Two general meetings, February 8 and 29, did not alter the state of affairs. After the mine Burbach gave formal notice of its intended withdrawal, some of the mines were deprived of the hope they had entertained that the agreement would be renewed according to a provision inserted in the contract that, should no member give notice of withdrawal before June 30, renewal would automatically take place.[4] Nevertheless the deadlock continued, each side accusing the other of a shameful display of selfishness.

Finally on June 27, a meeting called by the Prussian fisc convened in a sort of fatalistic hope that efforts would be successful. By June 30 minor questions had been disposed of and one by one the mines agreed to quotas assigned to them by a special commission. The government mines finally agreed to make concessions but the obstinacy of the representative of the Hedwigsburg mine brought the negotiations on that day to naught. The mine owners were brought together the next day; Hedwigsburg expressed willingness to enter the syndicate upon the somewhat more favorable

[1] K. R., vol. i, pp. 1201, 1157.

[2] K. R., vol. ii, p. 281.

[3] K. R., vol. ii, p. 310.

[4] Berliner Jahrbücher, 1904, p. 111.

terms offered.[1] Hohenfels had, in the interim, contracted with several American firms to deliver potash at prices considerably lower than those quoted by the syndicate.[2] This was adjusted, the syndicate assuming the contracts, and upon July first, the new syndicate was organized.

Upon August 11, the new syndicate (Kalisyndikat, G. m. b. H.) was entered in the commercial register at Bernburg as a limited liability company with a paid-up capital stock of 400,000 marks entirely owned by the members of the syndicate.[3] The adoption of the company form, merely a device to give juristic personality to the Kartell, was due to the desire to secure still firmer organization than had hitherto been possible. Potash products were regrouped into five groups, the first three of which included certain crude, mixed, and concentrated salts, the other two, crude salts. As before, members of the syndicate bound themselves to place the entire output of their establishments at the disposition of the central office which received and distributed orders. To increase the effectiveness of the syndicate's propaganda work, all individual trade marks were given up.

The administration of the syndicate was intrusted to three bodies: the general assembly (Generalversammlung) consisting of a representative from each mine; the supervisory council (Aufsichtsrat); and the syndicate

[1] K. R., vol. ii, pp. 542–544; Berliner Jahrbücher, 1904, pp. 111 et seq.

[2] Cf. article by C. H. MacDowell, of the Armour Fertilizer Works, one of the buyers. American Fertilizer, Feb. 25, 1911, pp. 31 et seq. Also K. R., vol. ii, pp. 542–544.

[3] The text of the agreement is found in the Denkschrift über das Kartellwesen, bd. i, 1905, pp. 503 et seq. (Stenographische Berichte des deutschen Reichstages. XI Legislaturperiode. II Session, 1905–06.) Summarized in Heimann, pp. 1494 et seq.; and in Berliner Jahrbücher, 1904, pp. 111–112.

management (Syndikatsvorstand). The general assembly was empowered to choose eight members of the council, to declare dividends, to determine the terms of sale, and, with some qualification, to amend the articles of the company. Any change in the prices of certain products, as well as any change affecting the privileges of the Prussian Minister of Commerce, required the votes of the government representatives to be among those concurring. Upon the supervisory council, of which the chairman was to be chosen by the Prussian Minister of Commerce and Industry, devolved the duty of selecting the officials composing the business management, and of exercising control over them. The syndicate managing staff (Geschäftsvorstand) consisted of a Generaldirektor, with three subordinate directors each in charge of one of the three departments into which the business was divided: namely, the central department, the agricultural bureau, and the business management proper, which again fell into four divisions dealing with (*a*) crude salts, (*b*) concentrated products, (*c*) American trade, (*d*) transportation. The Vorstand fixed prices annually, subject to the approval of the supervisory committee, upon the basis of kainite containing 12.4 per cent pure potash, the other prices being computed therefrom according to potash content. Export prices were to be higher for all except a few products with low potash content, — an exception of little importance since such products cannot be economically transported. By other provisions, the approval of the Prussian Minister of Commerce was made necessary for raising the base price. The right to quote special prices for German agricultural consumption was retained.

An arbitration board was established for the settlement of disputes. Penalties for breach of contract

took the form of fines ranging in amount from 100 to 300,000 marks. Appeal from the decision of the supervisory council was permitted. As security for the observance of contracts, each mine, except the fiscal establishments, was required to deposit 300,000 marks to the credit of the syndicate.

The fatal weakness of the syndicate contract lay in the fact that in it were incorporated no provisions for the admission of new members. In the anxiety lest the syndicate should not be continued, a most important question was glossed over and finally left unsettled. This defect was destined to cause constant difficulties.

The period of calm which followed the formation of the syndicate in 1904 was of short duration. The establishment of new mines, their increasing reluctance to enter the syndicate, and the difficulties and disturbance accompanying become the main features in the history of the potash industry. The syndicate led a precarious existence, threatened with destruction more than once in the course of the protracted negotiations connected with the entrance of certain mines into the organization.

When possible, the syndicate secured the assent of a prospective member to a provisional agreement and assigned a quota tentatively. Then began a process of higgling, the new mine demanding a high quota with the hope of obtaining eventually about what was desired, and occasionally enforcing its demands by threatening, or actually making, independent sales at low prices. The syndicate, on the other hand, commenced by offering a low quota with the intention of raising it if necessary. The fact that since 1900 the average output per mine had decreased in absolute amounts each year rendered the allocation of quotas the most difficult problem of syndicate management.

From 1900 to 1908, the average output per establishment decreased 41.5 per cent in quantity and 47.8 per cent in value.[1]

The speculation accompanying the revival of prosperity in 1905 found a favorable field in potash enterprises.[2] It was accentuated by the so-called Gamp law passed by the Prussian Diet for the purpose of preventing the multiplication of new mining enterprises. It was provided in this law that for two years from its enactment, no person should have the right to explore for, locate, or secure title to mining rights in the territory where Prussian mining law was binding. As it happened, Prussian mining law did not apply, in respect to potash salts, to Hanover, where all mining rights were the property of the landowner, not, as in Prussia, of the discoverer. Consequently, while the lex Gamp effectually checked potash exploration in Prussia, speculation merely shifted its base of operations to Hanoverian territory.[3] The purchase and sale of mineral rights, the lease of lands, and development on the royalty plan of land bearing potash, or supposed to bear it, furnished great opportunities for the promoter, and the basis for unprecedented potash speculation, and a flood of potash securities of which a gullible

| Year | Total Output in Millions of Doppelzentners | Total Value in Million Marks | No. of Concerns | Average Output per Concern | Average Value in Marks |
|---|---|---|---|---|---|
| 1900 | 30.4 | 56.2 | 15 | 202,407 | 3,748,688 |
| 1901 | 34.3 | 59.1 | 19 | 180,604 | 3,112,027 |
| 1902 | 32.9 | 56.9 | 24 | 137,057 | 2,370,379 |
| 1903 | 36.6 | 64.1 | 28 | 130,865 | 2,289,602 |
| 1904 | 43.0 | 74.1 | 28 | 153,621 | 2,645,634 |
| 1905 | 48.3 | 81.6 | 32 | 151,021 | 2,551,336 |
| 1906 | 54.8 | 91.7 | 36 | 152,093 | 2,546,777 |
| 1907 | 55.8 | 93.4 | 41 | 136,092 | 2,278,587 |
| 1908 | 59.2 | 97.8 | 50 | 118,315 | 1,956,264 |

Dr. Kreusham, in Kartell-Rundschau, 1911. — The doppelzentner contains 205 lbs.

[1] Heimann, pp. 1551 et seq.

[2] Heimann, pp. 1514, 1520, 1521; Berliner Jahrbücher, 1905, p. 120.

public never seemed to get enough. The Gewerkschaft,[1] a form of association in favor for mining enterprises, was, owing to a peculiarity in Hanoverian law, impossible to organize in that state. Nevertheless, the device of buying up the charters of small or defunct Gewerkschaften in Prussia and other states enabled promoters to circumvent the law, and gave rise to a flourishing trade in charters. Further, the lex Gamp did not affect mining rights already granted. Many enterprises, abandoned after the activity of the years following 1898, became once more objects of public favor and speculation.

It is impossible here to describe the negotiations connected with the admission of the various mines to the syndicate. But the case of Sollstedt, tho not typical, is of special interest because of the part played by it in the international complication of later years. In 1905, the Sollstedt mine, owned by H. Schmidtmann, began producing, and made its entrance into the syndicate conditional upon the adoption of certain reforms in the policy of the syndicate, among other things urging the adoption of a lower price basis.[2] Altho the opposition claimed that these reform demands were merely a cloak to hide the real demand for a large quota, one cannot deny that a policy of lower prices, in order to remove the incentive to the increase in the number of mines, was entitled to serious consideration.

Unable to secure the assent of the syndicate to his proposals, Schmidtmann closed contracts late in 1905 with several American potash buyers. When it became known that the syndicate was granting larger discounts

[1] The Gewerkschaft is divided into shares called Kuxe, each of which represents a definite fraction (e.g., 1/100, 1/128, 1/1000, etc.) of the capital. There is, of course, no fixed par value. The Kuxe are assessable.

[2] Cf. K. R., vol. iv, 1906, pp. 24, 93, 94, 208. Cf. also Statement in behalf of the Potash Syndicate, issued Jan. 20, 1911.

to the great fertilizer corporations, the Independent Fertilizer Manufacturers Association, consisting of some sixty-five companies, was formed and proceeded to contract with Sollstedt for more potash.[1] In all, the contracts called for the annual delivery of about 50,000 tons of pure potash at prices which, tho not specified, were guaranteed to be as low as those currently paid by the large fertilizer corporations. According to the prices paid for potash, American buyers might now have been divided into several groups: — first, the two large fertilizer corporations, receiving discounts of 11 and 13 per cent; next, the group of Sollstedt's customers, some of whom were under obligation to secure their potash from the syndicate up to Jan. 1, 1910 (deliveries to these were not to begin until 1910); other buyers, bound by contract to take their total potash requirements from the syndicate at discounts of 5 and 7 per cent; and buyers under no obligations and paying the current prices.

Schmidtmann was much criticized for his action. He was accused of lack of patriotism, of wasting a great natural resource for the benefit of a foreign nation instead of conserving it for the welfare of the German people. Since geological experts estimate the supply of potash salts to be sufficient to supply the world for 600,000 years, the ever-recurring arguments bearing on the subject of exhaustion have little force.[2] The true explanation of the hostile attitude against Schmidtmann and other mine owners who made low price sales to foreign customers, and against foreigners who attempted to buy potash mines, seems to be the belief that the possession of a natural monopoly ought to enable the nation to secure monopoly gains.

[1] American Fertilizer, Feb. 25, 1911, pp. 31 et seq.

[2] Estimate of Ochsenius. Cf. also, in this connection, xci Chron. 1515–1516.

At the close of 1905, Sollstedt was more unlikely than ever to enter the syndicate. Toward the end of January, 1906, there was serious talk of dissolving the combination. In the course of the negotiations the syndicate issued an ultimatum, offering quotas to Sollstedt and two other "outsiders," under threat that should the offer not be accepted, steps to effect the dissolution of the organization would immediately be taken. Schmidtmann in answer to this declared that the size of the quota was a minor matter, and that he was mainly concerned with the reforms in organization and in the price policy. No definite action as to dissolution of the syndicate followed. Negotiations were continued. The general meeting of the syndicate refused Schmidtmann's proposal to lower prices, and during the latter part of the year, the Sollstedt conflict, as it came to be known, was allowed to lag. The situation, critical as it was, was aggravated by the syndicate's difficulties with other mines, especially with Deutsche Kaliwerke,[1] which also presented a number of reforms as the condition of its entrance. The crisis became so acute that a number of mines were ready to give notice of withdrawal from the combination as soon as any mine except Sollstedt should sell a single doppelzentner independently.[2] Despairing of inducing Sollstedt to enter, it was proposed to make use of Sollstedt and Schmidtmann's connection with the mine Aschersleben (a member of the syndicate) to bring a suit for damages, alleged to have been suffered by the syndicate through the connection of the syndicate member, Aschersleben, with the outsider, Sollstedt. Schmidtmann, in his capacity as chairman of the supervisory board of Aschersleben, had carried through several transactions connected with the development

[1] K. R., vol. v, pp. 33, 103, 306, 307.

[2] K. R., vol. v, p. 307.

of Sollstedt, by the aid of Aschersleben funds; the shares of Sollstedt had been subsequently purchased by Aschersleben.[1] It is unnecessary to go into detail; the upshot of the matter was that a number of stockholders of Aschersleben formed a protective association and attempted to oust Schmidtmann. However, the affair began to clear up, and on May 10, Sollstedt agreed to enter the syndicate, the reform demands being postponed for later discussion and decision. The statement made later in connection with the potash controversy,[2] that pressure of public opinion and fear of government intervention caused Sollstedt finally to enter the syndicate, seems to be only partially supported by fact. Government intervention had been advocated, but for a different purpose, that of checking the increase of new mines, not the regulation of those already in existence.

By the terms of settlement, Sollstedt continued deliveries of potash to its American customers, paying fines for the excess over its allotment. The syndicate was, however, granted the option after January 1, 1908, of assuming the contracts calling for current delivery, while the new syndicate, should one be organized in 1909, was to have the option of assuming all the sixty-five or seventy contracts. The syndicate chose to make use of its option and, upon January 1, 1908, assumed the Sollstedt contracts as binding. Delivery proceeded smoothly for a time, but in June came an unusual influx of orders from the Sollstedt customers, and a corresponding decrease in the orders from those customers of the syndicate who were bound by contract to secure from it their total potash requirements. The officers of the syndicate concluded immediately that

[1] Berliner Jahrbücher, 1906, p. 96; 1907, p. 121; K. R., vol. v, pp. 231, 390, 559, 560.

[2] Statement in behalf of the Syndicate, p. 9.

the Sollstedt customers intended to resell potash to purchasers already obligated to the syndicate, — a conclusion strengthened by complaints of discrimination. The syndicate did not propose to allow any surplus for resale and accordingly restricted deliveries. Sollstedt's American customers protested against this violation of contract and refused to acknowledge the transfer of the contracts to the syndicate. Sollstedt, contrary to contract, resumed independent delivery in July, pointing out that the alleged intended breach of contract on the part of the syndicate's customers did not call for the violation of another agreement, in order to punish the offenders. Owing to the fact that Sollstedt had deposited large security guaranteeing delivery, the Americans could exert considerable pressure. The syndicate accepted the situation without further action at the time.[1]

The trouble with Sollstedt, tho the most serious encountered during the existence of the fourth syndicate, by no means stood alone. The mines Rossleben and Ronnenburg which also applied for admission to the syndicate in 1905, settled the quota problem by a compromise and became members in March, 1906.[2] In the same year the Kaliwerk Friedrich Franz entered, in which the government of Mecklenburg was chief stockholder; and the Prussian fisc, in order to strengthen its position in the syndicate, bought the mine Hercynia.[3] The influence of the group of newer mines had been constantly increasing, and at the general assembly in November, 1906, they were able to elect a majority of the supervisory council.[4] They proceeded to make

[1] American Fertilizer, Feb. 25, 1911, p. 32; Statement of the Syndicate, p. 10; K. R., vol. vi, pp. 649, 743, 744.

[2] K. R., vol. iv, pp. 24, 93.

[3] K. R., vol. iv, pp. 23, 24.

[4] K. R., vol. iv, p. 32.

use of their power in an attempt to introduce a reorganization of the syndicate's technical and mercantile policy. This was much facilitated by the change in general directors in February, 1907, following a long dispute and a series of complaints of favoritism to the older mines.[1] But the competition of Sollstedt and the Deutsche Kaliwerke, which threatened the very existence of the syndicate, directed efforts toward inducing these to enter the fold.[2] The agreement with Sollstedt has been mentioned. The set of reforms advocated by the Deutsche Kaliwerke were given up, as in the case of Sollstedt.[3] The question in dispute was finally limited to one of quotas. After appraisal by a special commission and several conferences, the long protracted negotiations came to a close. The syndicate ratified the entrance of Sollstedt and Deutsche Kaliwerke on June 19, 1907. A few months later, in November, three new mines were added to the syndicate membership.[4]

The year 1908 brought no halt to the increase in the facilities for the production of potash. But the older members of the syndicate were surprised when they heard that a group of capitalists representing the powerful agrarian association, the Bund der Landwirte, had purchased extensive potash properties with the intention of establishing still another potash mine.[5] In view of the distinctly friendly attitude which the syndicate had always shown toward the agrarian associations, it was not to be expected that they would seriously consider competing with the syndicate. The syndicate was successful during the year in inducing all "out-

[1] For particulars see K. R., vol. v. pp. 134, 166, 232, 306.

[2] K. R., vol. v, pp. 103, 166, 306, 391.

[3] K. R., vol. v, p. 33.

[4] K. R., vol. v, pp. 559, 560.

[5] Berliner Jahrbücher, p. 141; K. R., vol. vi, p. 292.

siders" to become members of the organization. At the close of 1908, there were forty-nine mines in operation all of them syndicate members; sixty-five companies in addition had already begun borings and shafts.

A distinct development of the potash industry in this period, was the organization of companies to buy up potash lands in order to prevent the establishment of more mines. Several of the newer mines, headed by the Deutsche Kaliwerke, organized a company (Vereinigungsgesellschaft für Kalibergbau) to buy up potash properties with the express purpose of demanding in return for not developing them, an excess quota from the syndicate, so that reasonable interest on the investment in potash properties could be paid.[1] A group of the older mines also formed a similar association, the Schutzbohrgmeinschaft. Its offer to sell the fields it had acquired to the syndicate was rejected.

The continued over-development of facilities for potash production was due to a complex of causes rather than to any single factor. Various peculiarities of the potash industry have made it a favorite for investment and speculation. The participation of the government in the industry and the patriotic desire to invest in home enterprises doubtless had an influence. But Germany's possession of a natural monopoly and the unusual profitableness of the industry have certainly been prime factors. Dr. Pinner gives interesting figures.[2] In 1906, which he considers a normal year, the average profits of twenty-one mines was 15.9 per cent, while dividends of 13.5 per cent were

[1] K. R., vol. v, pp. 638–639, 785–787.

[2] Article in Die Bank, 2 Jhrg. Heft 2, 1909, pp. 133–145; summarised in American Fertilizer, 1909, Sept., p. 20.

declared.[1] Within two years the average dividends were decreased to 9.5 per cent, because of the increase in the number of mines and the decreased average output. Upon the basis of expert opinion, Dr. Pinner states that the cost of production of potash salts varied from 40 to 60 per cent of selling prices. With the smaller average output per mine in 1908, the proportion was somewhat higher, but still low as compared with other mining industries.[2] Potash mine owners do not neglect to make large deductions for amortization and depreciation.[3]

The fact that the capital required for developing a potash mine is considerable seems to have had little effect in checking production. The capital stock of each of the twenty-one mines mentioned above was, with one exception, in excess of $400,000; the average was well over $1,000,000. The average cost of a boring ranges from $15,000 to $25,000, and one at least must be made preliminary to the sinking of a shaft. The risks of the potash industry were insufficient to check investment, altho they are of a peculiar nature, especially the danger of water dissolving the salts.

In addition to the unusual profitableness of the industry, one must mention among the inducements to speculation the attempts of the Prussian government to regulate the industry. Reference has been made to the Gamp law. Prominent among the arguments of its proponents was that the passage of such a measure was the only means of preventing potash fields from being monopolized by private individuals. The objection to the law, that a large number of boring companies

[1] The averages are probably somewhat too large. *Cf.* Bericht der 9. Kommission. Aktenstücke zu den Verhandlungen des Reichstages, Nr. 475, 1909–10, pp. 2430–2431.

[2] Compare Aktenstücke, Nr. 475, 1909–10, cited above, pp. 2418–2422.

[3] Groth, pp. 18 et seq.

would be destroyed, was not borne out. Instead, the law greatly increased the value of their holdings. An instance is reported in which the International Boring Company, at Erkelenz, working with a capital of 1,000,000 marks, had acquired a large number of potash fields, and sold them several months after the enactment of the law for 35,000,000 marks.[1] Tho the lex Gamp was superseded July 8, 1907, by a new mining law, its provisions were in essentials continued.[2]

The extension of the police requirement that every mine have at least two passable exits was also instrumental in increasing the number of mining companies.[3] The construction of a second shaft necessitated for many mines a large outlay of capital. Since the ordinance could be complied with by connecting two adjoining mines underground, this method was adopted by some of the mines.[4] Other mines holding extensive tracts of land complied with the law by constructing a second shaft, but, in addition, organized a subsidiary company to take charge of it, and the new company proceeded to demand an independent quota from the syndicate. Among the members of the syndicate which adopted the latter course were Burbach, Westeregeln, Glückauf-Sondershausen, Aschersleben, New-Stassfurt, and Rossleben.

## V. The Renewal Negotiations, 1908–1910

Negotiations concerning the renewal of the syndicate began nearly a year and a half before final decision was necessary, — in itself striking evidence that great

[1] Berliner Jahrbücher, 1905, pp. 107 et seq.

[2] For the laws affecting the mining of potash, see Anlage 34 zu Nr. 475. Aktenstücke, 1909–10, pp. 2462–2465.

[3] Berliner Jahrbücher 1907, p. 123; 1908, p. 138. Also K. R., vol. vi, p. 450.

[4] Cf. Aktenstücke, Nr. 475, 1909–10, pp. 2436–2437.

difficulty was expected.[1] At a general meeting of the syndicate on January 14, it was decided that the supervisory council should submit before May 1 the draft of a new contract. Pending the outcome of the negotiations, the council succeeded in inducing ten mines to refrain from "outside" sales till June 30, 1909. In the hope of strengthening their influence in the syndicate, a number of the mines began to divide their ownings, intending to use the fields controlled by subsidiary companies as defense against the reduction in quota which was bound to come. As an instance, Glückauf-Sondershausen announced its intention of transferring its reserve fields to six subsidiary Gewerkschaften. The supervisory council proceeded to ask each mine owner to hand in a written statement of his suggestions for reform.[2] In the replies, the evils of the existing situation were evidently recognized by all, but the proposed remedies revealed much divergence of opinion.[3] The propositions of a group of Hanoverian mines, to which ten or eleven mines expressed complete agreement, give some light on the points of controversy. They advocated the creation of a second council (Beirat) to relieve the supervisory council of some of its many duties under the old organization. The duration of the new syndicate should be ten years. The admission of new members was to be left to an arbitration board. Products were to be sold under certified analyses. Transfer of quotas from one mine to another (under restrictions) was to be facilitated. All these propositions, as well as sundry others, were actively opposed. Transfer of quotas was especially

[1] K. R., vol. vi, pp. 206, 286; vol. vii, pp. 261, 345, 443.

[2] K. R., vol. vi, p. 288.

[3] K. R., vol. vi, pp. 364, 117 et seq. Cf. in this connection Emil Sauer's proposals K. R., vol. vii, pp. 102 et seq.

opposed by the fiscal representatives on the ground that it would further the " Vertrustung " of the industry. It would undoubtedly have increased consolidation, and the government's fear of having several less efficient plants shut down, and a number of laborers thrown out of employment thereby, was a chief factor in determining its attitude. Another proposal was that each mine should receive an additional quota for each undeveloped potash field in its possession. The adoption of such a measure would have greatly altered the appearance of the allotment table. For instance, Glückauf-Sondershausen, owning 258 fields, had at the time a smaller quota than another mine with only four.

During the spring and early summer of 1908, the committee of the supervisory council in charge of the renewal negotiations worked constantly to eliminate as much of the friction as possible. The Prussian government had early expressed its opinion that renewal of the syndicate was by all means to be desired; doubt as to the attitude of the fisc was no longer a deterrent factor. It had been stated frankly that should the fisc decline to become a member of a new combination, the chances were overwhelmingly against its formation. The expressed wishes were, as far as possible, embodied in the draft of a new syndicate contract which was submitted to the supervisory council at Eisenach on July 2.[1] According to its provisions, the power of the potash syndicate was to be extended from the sale and purchase of potash to the acquisition of property and other rights. Potash products should be sold according to analyses of their exact chemical content. It was planned to create a second council

[1] Berliner Jahrbücher, 1908, p. 141.

(Beirat) to assist the supervisory council. The seat of the syndicate was to be changed from Stassfurt to Berlin, — a concession to the younger mine owners, who believed that there the connection between the syndicate and Ministry of Commerce would be more intimate, and that the syndicate would be in closer touch with the great agricultural associations having central offices in Berlin. Of more importance was the proposed freedom to transfer quotas from one mine to another, when owned by the same firm.

The renewal negotiations were in the main a repetition in intensified form of those in 1903 and 1904.[1] As before, a new agreement must be concluded before June 30 of the year of expiration, in order to avoid the complication of outside sales. The hope of speedy renewal vanished as the months passed, and the entire second half of the year was devoted to discussion of the plan of reorganization; the chief question, that of allotments, was shelved until an agreement on other points should be reached. Among the mass of articles and reports which filled the press, an article of Dr. Wächler, the chairman of Salzdethfurth, one of the older mines, attracted special attention. Pointing out that the syndicate was not in a position to avoid overproduction, he declared that the régime of competition was the only remedy. The elimination of all the less capable companies would place the industry once more on a firm basis. But the opponents of Wächler's view claimed that the excess of mining facilities was the fault of legislation, not of the syndicate, and that price cutting would deprive Germany of all advantage from her natural monopoly. They also stated that free competition would cause emormous losses to a great

[1] K. R., vol. vi, pp. 1043 et seq.

number of security holders interested in the prosperity of the industry.

When the commission of the syndicate met on January 5, 1909, three sub-committees were chosen, one to deal with the hotly contested question of changing the domicile of the syndicate, a second with the question of the increased utilization of carnallite (urged by the carnallite mines, which felt that their product was not being actively pushed) and a third with the question of the size and transfer of allotments. On April first, a new syndicate plan was published, which left the question of location open, but proposed changes allowing transfer of quotas between the groups of products and between mines. After a discussion by the full commission, and restriction of the right of transfer to suit the Prussian Minister of Commerce, the general assembly, consisting of representatives of all mines belonging to the syndicate, and others about to enter, took up the most difficult problem, the allocation of allotments.[1] It was strongly urged that the old allotment table be taken as a basis and that quotas for the new mines be provided for by a 10 per cent horizontal deduction from the quotas of the older mines, the required balance to be assigned pro rata. But this scheme, as well as others proposed, failed of acceptance, and the allotment question was again referred to a committee, which prepared accordingly a new allotment table, but with as little chance of acceptance as before.

Since there was little doubt that lower prices would follow the dissolution of the syndicate, American potash buyers could hardly be expected to favor its continuance. All the pressure which could be brought to bear on the situation was exerted against the combination. The

[1] Berliner Jahrbücher, 1909, p. 167.

Virginia-Carolina Company owned 702 of the 1000 shares of Einigkeit, controlling therefore that mine. Nothing substantial appears to have come out of the rumored negotiation between the mine Teutonia and the American Agricultural Chemical Company; the rumor caused a flurry of excitement and the publication of numerous articles under such captions as "Vaterländische oder Amerikanische Bodenschätze?" with repeated patriotic warnings against the invasion of foreign capital. This had the material result some time later of causing such transfers of mining property to foreigners to be dependent on official sanction. That American influence was exerted against the syndicate is shown more distinctly in the transactions concerning Sollstedt and Aschersleben. The chief stockholder, H. Schmidtmann and his son, W. Schmidtmann, had long been dissatisfied with syndicate management. They wanted to operate at full capacity. The American market was a favorite because of its great capacity to absorb potash, and the high potash content of the wares demanded. Schmidtmann had already secured a huge slice of the American trade by the "outside" sales of Sollstedt in 1905–06. With some of the American independents he had contracts for delivery up to 1917. Consequently he was not at all averse to the idea of combining the independent buyers. Should such a combination be formed he would contract to furnish potash at low prices. This would please the American potash buyers. Schmidtmann would have long time contracts for deliveries of potash, and would be entrenched against the revulsion which might follow the dissolution of the syndicate; if renewal were effected, he was in a position to force the syndicate to accede to his demands. However, the attempt of W. Schmidtmann and C. F. Meadows of Baltimore to organize

the Independent Fertilizer Company in the fall of 1908 fell through. A second attempt to combine the independent fertilizer manufacturers in the U. S. Agricultural Corporation, chartered in April, 1909, also bore no result. The third attempt was successful. Between midnight June 30 and daylight July 1, presumably, the International Agricultural Corporation with W. Schmidtmann as president and C. F. Meadows as treasurer came into being, having obtained possession in that same short space of time of the Sollstedt mine, and sold potash which it had bought from Sollstedt. America was, and is, outside of Germany itself, the syndicate's biggest customer. Its influence, exerted at a critical period in the life of the combination, had the inevitable effect of increasing the difficulties of renewal.

In spite of all the complications, it was believed that the syndicate would be renewed at the meetings to be held the last of June.[1] Prospects brightened during that month. Many of the special demands were withdrawn and differences compromised. When the final meeting convened at Berlin, potash buyers from many countries had assembled in the imperial city to await the outcome of the negotiations, the American delegation being conspicuous.[2] Their purpose was clear. In the event of the dissolution of the syndicate a price war would be the probable result, and buyers on the spot would be able to secure cheap potash. The meeting on June 29 was devoted to the discussion of allotments. Negotiations were resumed on the following day. By ten o'clock that evening, thirty-five mines had signified their willingness to enter on the terms offered. At eleven, the Prussian fiscal representative

[1] Berliner Jahrbücher, 1909, pp. 168, 682.

[2] American Fertilizer, July, 1909, p. 23.

announced that unless there was unanimous agreement by midnight, he would proceed to make independent sales. After a dramatic session, the obstinacy of one mine owner defeated the efforts at renewal.[1] The remaining representatives (of forty-one mines) agreed informally not to make any sales independently until after July 1. On July 1, it was learned that the representatives of the Westeregeln group, the Einigkeit, and the Schmidtmann mines, Aschersleben and Sollstedt, had made large independent sales of potash after leaving the hall at midnight. This added complication precluded the possibility of organizing a new syndicate on July 1. But the provisional agreement was continued to July 8 and then extended to July 24.[2] In the meantime the German government had threatened to levy an export duty on potash, and the Westeregeln group had succeeded in annulling its "outside" contracts. Upon July 24, a new syndicate was organized, not including Sollstedt, Aschersleben and Einigkeit, — those mines in which American influence was strongest. It was to be located at Stassfurt and its continuance was contingent upon the satisfactory adjustment by the three outsiders before September 30, of their independent sales.[3] But nothing having been accomplished, a "Kampf-syndikat" was formed without them (on September 30).

Sollstedt, through the International Agricultural Corporation, its owner, proceeded to sell potash to all the independent buyers with whom it had previously contracted, on the same terms as had been granted to the American Agricultural Chemical Company.

[1] Berliner Jahrbücher, 1909, p. 168; K. R., vol. vii, p. 683.

[2] K. R., vol. vii, p. 723.

[3] K. R., vol. vii, pp. 723, 799. Berliner Jahrbücher, 1909, p. 169. For the charges of the syndicate against Schmidtmann, see K. R., vol. vii, pp. 840–841.

The total of the contracts (including those of Einigkeit and Aschersleben) involved seven or eight million dollars and called for about 120,000 tons of pure potash, or four-fifths of the annual American importation. The contracts, binding for two years, were provided with options on a five year extension.[1] The unsuccessful attempts of a German commission [2] sent over in August to induce the Americans to give up their valuable contracts, — valuable because the prices quoted were about 30 per cent lower than current syndicate prices.[3] The fact that the syndicate policy of making the export trade pay the largest part of the profits did not operate as nicely when two-fifths of the export trade was taken away, the arguments concerning the dissipation of a national resource, the strengthening of foreign nations at the expense of the Fatherland and the like, — all these increased the clamor for legislative interference. As a result, the Prussian government submitted in December a proposed imperial potash law to the Federal Council of the Empire. Tho the idea of a direct export tax was given up, the bill proved especially displeasing to the Hanoverian faction; and since it practically nullified American contracts, the opposition which developed caused its withdrawal.[4]

A second committee of the syndicate, which came over to America in December, was as unsuccessful as the

[1] Statement of the Potash Syndicate, p. 15. Also lxxxix Chron. 412; xc Chron. 630. K. R., vol. viii, pp. 243, 331.

[2] American Fertiliser, August, 1909, p. 8; K. R., vol. vii, p. 799.

[3] Statement in behalf of the Potash Syndicate, p. 15. The price for muriate of potash was about $20.30 per ton. The syndicate price at the time was about $33.00 per ton. See also American Fertiliser, Dec. 3, 1910, p. 20.

[4] Deutsche Ökonomist, vol. xxviii, pp. 24, 110; K. R., vol. vii, pp. 840–841. Statement of the Syndicate, p. 11. Berliner Jahrbücher, 1909, p. 170.

first.[1] About this time treaty negotiations in connection with the Payne-Aldrich Tariff were in progress. Following the exchange of a number of informal notes, the United States representing that an export duty would be considered undue discrimination against American trade, the State Department was reported, on January 17, to have received assurances that the German government would not press its scheme of levying an export tax. Germany was soon after accorded the privilege of the minimum tariff.[2]

On February 4, the draft of a new potash law was brought before the Reichstag by the Federal Council. After a lively debate (February 14 and 15, 1910), in the course of which it became clear that the low price American contracts were at least the occasion of the bill, it was referred to a committee of twenty-eight.[3] Much altered, it came back to the Reichstag and was passed on May 25, 1910, going into force three days later.[4]

The potash law, thus finally enacted [5] provides for imperial control over the production and selling prices of potash salts until December 31, 1925. The allocation of allotments becomes the duty of the "königliche Verteilungsstelle," a commission of which the chairman and two other members are chosen by the Chancellor, subject, however, to ratification by the Federal Council. The other members are chosen by the mine owners.[6] The Verteilungsstelle estimates a total output sufficient

[1] American Fertiliser, January, 1910, p. 18. K. R., vol. viii, p. 33.

[2] American Fertiliser, February 15, 1910. Also xc Chron. 1557, K. R., vol. ix, pp. 35, 149.

[3] Berliner Jahrbücher, 1910, p. 145; Deutsche Ökonomist, vol. xxviii, pp. 24, 25, 109.

[4] For the report of the commission, see Bericht der 9 Kommission, Anlage Nr. 475, zu Stenographische Berichte usw. 1909–10.

[5] Text of the law in Reichstagsverhandlungen, Nr. 219 der Drucksachen 1909–10, also reprinted in Kartell-Jahrbuch, Bd. i, Heft 2.

[6] *Cf.* Abschnitt I, §§ 7, 8.

to supply the world's demand, and apportions it among the potash producers. For the same mine, the percentages of domestic and export output must be the same, in order to prevent the possibility of any mine devoting itself exclusively to the export trade.[1] For the current year a scale of prices which should serve as the maximum for domestic and as a minimum for export, was embodied in the law.[2] Any potash mine which delivers salts in excess of its legal allotment must pay into the imperial treasury a tax of from ten to eighteen marks for every doppelzentner in excess of its quota.[3] This is in addition to the regular (and almost nominal) tax of sixty pfennige per doppelzentner levied upon the total output of potash, whose proceeds go to pay the expense of administration of the law, any excess being used for propaganda purposes.[4] The Federal Council is empowered to lower the surtax in the case of contracts executed before December 17, 1909, so that the contract prices plus surtax shall not exceed the prices current before June 30, 1909.[5] For the purpose of checking the increase in the number of producers, the law provides that a new mine shall receive an allotment from the first, but one smaller than its capacity would entitle it to demand.[6] Not until the third year shall full allotments be granted.[6] Mines with two shafts shall receive a 10 per cent addition because of the second shaft.[7] Allotments may be transferred between groups of products or transferred or exchanged with other mines;[8] but the transfer of over half an allotment requires official consent.

As an example of social legislation, another provision requires attention.[9] It is provided that whenever a potash mine reduces wages or lengthens the time of

[1] Abschn., I, § 8. [2] Abschn., II, § 20. [3] § 26. [4] § 27.
[5] § 46. [6] §§ 12, 13. [7] § 11. [8] § 17. [9] §§ 13, 14.

employment, its quota is to be reduced by the Verteilungsstelle, on the ground that such action is *prima facie* evidence that capacity has decreased. In the decision, the Verteilungsstelle must call in two labor representatives to act as part of the court. Employees in mines or factories which close because of transfers of allotments are entitled to compensation from the mine owners, up to the amount of twenty-six weeks' pay.

The law provided for no compulsory syndicate. But under the altered conditions which it brought about the Kampf-syndikat of September 30, 1909, was dissolved, and a new one came into existence on June 7, 1910.

## VI. The Potash Controversy between Germany and the United States

The potash sold to Americans by the Aschersleben, Sollstedt, and Einigkeit mines was in amount far in excess of their quotas under the new law. The greater part, hence, was subject to the supertax, which nearly equalled the selling prices of the salts. The mines Aschersleben and Sollstedt refused to continue deliveries unless the Americans would assume the tax. The American holders of low price contracts would not agree to this, since assumption would mean their paying higher prices for potash than those who bought from the syndicate.[1] They denied that the tax was a charge of the nature implied in their contracts, the wording of which was "that any governmental duty should be assumed by the buyers." They maintained it was a penalty for violation of a German law.[2] Expert legal

[1] K. R., vol. viii, p. 771.

[2] American Fertilizer, August 10, 1910, p. 22.

opinion on both sides of the Atlantic split on the question. In Germany the majority held the Americans to be liable for payment of the tax; in America the opposite opinion prevailed. The necessity of securing potash for current requirements forced the Americans to pay the tax which they did under protest.

Fertilizer interests in this country denounced the law as a practical repudiation of contracts made in good faith, and appealed to the State Department for aid. As soon as the matter could be taken up, in the fall of 1910, it became evident that the Germans did not wish to concede any more ground than was absolutely necessary. The Federal Council refused to consider a reduction of the supertax in the case of the options, according to which the buyers had demanded a five year extension of contracts, in June, 1910.[1] A commercial representative of the State Department, accompanied by a group of fertilizer manufacturers proceeded to Europe in September. He declared two months later that no settlement could be made; that the application of the maximum clause of the tariff act of 1909 was in order, since the German law clearly was discriminatory against America.

The controversy reached so acute a stage in December that President Taft submitted the whole matter to the Cabinet. Protests of fertilizer manufacturers, of farmers and other potash consumers continued to arrive at the State Department. Upon January 20, 1911, the potash syndicate presented a statement[2] for the consideration of the President and the Secretary of State. In contrast to the inflammatory protests of American fertilizer manufacturers, the syndicate's

[1] Berliner Jahrbücher, 1910, p. 150; K. R., vol. viii, p. 571.

[2] Statement in behalf of the Potash Syndicate. Dated January 20, 1911. Cf. also K R., vol. ix, p. 221.

brief was a sober and dignified presentation of the case; tho the inclusion of a number of misstatements and assertions insufficiently proved laid it open to attack.[1] But it seemed that the crisis had passed. The demand of our State Department for a definite statement from the German government elicited a reply which was not made public, but seems to have led to the adoption by our government of the attitude which the German had maintained, namely, that the affair was one to be settled by the parties concerned, and not by international diplomacy. After a series of conferences at Hamburg, an agreement between the Americans (except the International Agricultural Corporation) and the syndicate was reached.[2] Before the controversy could be finally settled, it was necessary to arrange matters with the Aschersleben and Sollstedt mines, which still insisted upon delivering potash subject to the supertax. But negotiations progressed so rapidly that a compromise was soon agreed upon.

The provisions of this final settlement [3] were in brief, (*a*) the withdrawal of all suits in our courts involving liability for the payment of the potash tax levied by Germany; (*b*) the assignment to the syndicate of the American contracts with independent mines; (*c*) new contracts with the syndicate, covering full American potash requirements for five and one-half years on a price basis practically the same as that prevailing before the low price contracts were obtained from the independent mines; and (*d*) the reëntry of the independent mines Sollstedt and Aschersleben into the syndicate. Aschersleben bought one-half of the Sollstedt shares from the International, and upon January 1, 1911,

[1] Cf. for instance American Fertilizer, January 28, February 10, February 25, 1911.

[2] xcii Chron. 1438. Also Kartell-Jahrbuch, Heft 2, p. 134; xcii Chron. 1535; K. R., vol. ix, p. 493.

[3] xciv Chron. 70.

Sollstedt entered the syndicate. The German government agreed to refund about 60 per cent of the supertax held in escrow in American banks. Aschersleben received 1,050,000 marks from the American Agricultural Chemical Company and the same amount from the International in return for its consent to annul the "low price contracts." [1]

The Einigkeit mine, one of those which made independent sales, was not much involved in the controversy. The low price sales to the Virginia-Carolina Company were insufficient to cover requirements. Forced to buy the balance of its potash from the syndicate, an amicable arrangement was made in 1910, whereby Einigkeit became a member of the syndicate December 31 of that year, paying a sum of about $50,000 to the syndicate as a compensation for "outside" deliveries already made.[2]

## VII. The Working of the Potash Law of 1910

The potash law was not a measure concocted on the spur of the moment to deprive American potash buyers of the benefit of their contracts. Legislation and combination had long been directed to the purpose of preventing ruinous competition among potash enterprises. The law was merely the culmination of a movement toward conservation. No doubt action was hastened by the low price American contracts. Technically, the law was not discriminatory. It applied to all potash in excess of the legal quota of a mine, whether for domestic or export trade. The payment of the tax

[1] Kartell-Jahrbuch, Bd. ii, Heft 3, p. 265. The account of the settlement in U. S. Consular and Trade Reports differs in certain minor details from that given above. (Nov. 11, 1911, p. 761.) Cf. also Consular Reports, November 25, 1911, vol. xciv, p. 70.

[2] Kartell-Jahrbuch, Bd. i, Heft 4, p. 45; K. R., vol. ix, p. 125.

was a question of contractual liability and the fact that Americans were chiefly involved was no proof of truth in the accusation of undue discrimination.

But if the law was successful in preventing low price potash sales, it was in other respects far from being as successful as its originators predicted. Instead of checking the continued increase of new mines, its effect was similar to that of previous attempts at legislation, in furthering the evil it was intended to prevent. As soon as it went into effect a new wave of development began. Not only were vacant fields divided and subdivided to form bases for new enterprises, but the syndicate mines also proceeded to divide their properties to a greater extent than before, founding new subsidiary companies with extra quota demands. Since a concern was legally entitled to a larger quota if two or more shafts were operated, and since, under the law, each new mine was guaranteed a quota, it became necessary for any mine which did not wish to have its quota reduced below a level which would leave a profit, to establish two or three subsidiary companies. Instances are numerous. Aschersleben divided its possessions to form four new enterprises. Out of the original properties of the Gewerkschaft Hugo a full half dozen mines were formed by division. From the Gewerkschaft Amelié eleven new undertakings have been organized, and the list might be continued.[1] With the honorable exception of Prussia, governments have been as great sinners as private enterprises in the promotion of new mines. Anhalt has four and plans two more. In April, 1911, in addition to the sixty-nine syndicate mines, seventy-nine were in process of construction, and about fifty more had either completed

[1] K. R., vol. xi, pp. 201, 198.

or were making borings.[1] A year later, ninety-seven mines were prepared to deliver potash, and a hundred and thirteen were in process of construction.[2] Dr. Paxmann stated in the spring of 1913 that one hundred twenty-seven mines were operating, one hundred thirty-two in construction.[3] The failure of the law in this regard is unmistakable.

The potash law had another effect not desired by its promoters, that of furthering concentration within the industry. The extension of the movement toward concentration which had become a feature of coal mining and banking, was much delayed by the hostile attitude of the syndicate of 1904, — an attitude inspired by the fiscal representatives, opposing transfer of quotas. Yet the opposition of the syndicate had not been sufficient to keep away concentration entirely. The fear of the loss of influence shared by the fiscal mines, should the private enterprises be free to combine, added little to the deterrent influence. During 1905 certain mines secured control of others by means of stock ownership. Westeregeln backed by the Mitteldeutsche Kreditbank acquired three-fourths of the shares of the new mine Rossleben. The Schmidtmann mine, Aschersleben, purchased the shares of the mine Sollstedt; and other instances might be given.[4] Yet until 1909, there had been little immediate advantage, except as investment, from the control of one mine by another. Concentration of production was practically prohibited, despite the fact that mines were operated at only a third or quarter of their capacity.

The freedom granted by the potash law in the matter of transferring quotas was a great incentive to concentration. Mines began to buy up quotas or controlling

[1] K. R., vol. ix, p. 401.

[2] K. R., vol. x, p. 472.

[3] K. R., vol. xi, pp. 43, 202.

[4] K. R., vol. iii, p. 325.

interests in other mines. The Wintershall mine, to which belonged the mines Heringen and Heiligenroda, acquired a majority of the shares of Bismarckshall, and secured control over five other mines. Later it was reported to have obtained control over two subsidiary companies of the Gewerkschaft Amelié.[1] The fusion of the Deutsche Kaliwerke concern and the Amelié was another notable instance. In the next year, 1912, the movement continued, the cases most discussed being the combinations Einigheit-Prinz Adalbert,[2] and Burbach-Krügershall.[3] In nearly every case, the combination of mines was accomplished by means of stock ownership.[4] The purpose was usually at least one of three: (*a*) to save capital outlay in the construction of the second shaft required by the police ordinance; (*b*) to transfer or exchange quotas so as to concentrate production in the best situated mine; (*c*) joint ownership and administration of power plants and branch railroads, or division of risk.

Denunciations of the potash law began six months after its passage and have grown in number and vehemence.[5] The opinion is now freely expressed that the potash law is a failure; that in order to make a small saving, it has induced speculation and waste of millions. The government finally recognized that the law had not been operating as intended, in a speech of Minister of Commerce Delbrück.[6] The potash industry became the object of a two days' debate[7] in which a lively discussion as to the employment of the propaganda money

[1] Berliner Jahrbücher, 1910; K. R., vol. ix, pp. 38, 224.

[2] K. R., vol. ix, p. 566.

[3] K. R., vol. x, p. 165.

[4] K. R., vol. x, p. 387.

[5] K. R., vol. ix, p. 401.

[6] Stenographische Berichte des deutschen Reichstages, 19. Sitzung 4 März 1902, p. 447; 20. Sitzung, 5 März 1912, p. 485. (Bd. 283.)

[7] Stenographische Berichte, etc., 29. Sitzung, 30. Sitzung, pp. 470 et seq.

was a prominent feature. The tax of sixty pfennigs had yielded a sum much larger than was deemed necessary for propaganda purposes. Prosposals to reduce this tax, to allow the excess to go into the imperial treasury, to spend the money more freely, as well as the more important debate on the general ill-success of the law brought at the time about no amendment. Debate was resumed in January of this year (1913), and finally a resolution was adopted to the effect that any reform or amendment to the potash law should be binding for all mines commenced after January 15, 1913.[1] Hanoverian conditions present some difficulty but it is generally expected that an amendment or revision of the imperial potash law so as to remedy some of its weaknesses will be forthcoming in the near future.[2]

## VIII. Conclusion

In its influence on prices, the potash syndicate has differed somewhat from other Kartells. Except for very short periods, export prices have been higher than domestic. Having a monopoly of the products, there has been no necessity for a resort to the "dumping" which has been a practice of the steel and coal Kartells. This has always proved an effective pro-syndicate argument. Prices have certainly been steadied. Statistics of prices show no decline in the price of muriate of potash since the formation of the first agreement in 1879, and none on carnallite since 1888, the date of the formation of the first syndicate.[3]

[1] K. R., vol. xi, pp. 111–113.

[2] Meanwhile a memorial prepared by Dr. Paxmann is attracting attention. He advocates a license system by which a government concession, to be granted only when the demand for potash warrants it, shall be required for opening up a new mine. K. R., vol. xi, 1913.

[3] The following figures are given by Paxmann (p. 125):

The potash syndicate has at all times attempted to secure the maximum gain, but has realized that the demand for agricultural purposes is capable of great expansion, and that the highest prices may not be the most profitable. In general, potash prices, tho not to be classed as extortionate, are said to have been higher than the demand for the product, the cost of production, or the interests of the industry itself justify. The fact that mines running at much lower than normal capacity could, in 1906, pay dividends averaging 13.5 per cent; that the cost of production was a considerably smaller part of the selling price than in other mining industries; the fact that Schmidtmann and others could contract to deliver large quantities of potash at 30 per cent below prevailing prices, with the expectation of still securing profit therefrom, — all these indicate a range of prices above the competitive level.

| Year | Price of Carnallite in marks per Doppelzentner | 80 per cent Muriate of Potash Marks per Doppelzentner | Year | Price of Carnallite in Marks per Doppelzentner | 80 per cent Muriate of Potash Marks per Doppelzentner |
|---|---|---|---|---|---|
| 1861 | 1.60 | 36.00 | 1881 | 1.00 | 12.70–16.00 |
| 1862 | 1.60 | 30.00 | 1882 | 1.00 | 14.50 |
| 1863 | 0.80–1.60 | 27.00 | 1883 | 1.00 | 13.50 |
| 1864 | 0.80 | 24.00–19.50 | 1884 | 1.12 | 13.26 |
| 1865 | 0.80 | 19.50–12.50 | 1885 | 1.12 | 13.36 |
| 1866 | 0.80 | 12.50–13.00 | 1886 | 1.12 | 13.32 |
| 1867 | 0.80 | 12.50–13.00 | 1887 | 1.12 | 13.34 |
| 1868 | 0.80 | 12.70–13.20 | 1888 | 0.80 | 13.38 |
| 1869 | 0.80 | 13.00–14.50 | 1889 | 0.80 | 13.43 |
| 1870 | 0.80 | 13.80–18.50 | 1890 | 0.80 | 13.45 |
| 1871 | 1.10 | 18.16–18.50 | 1891 | 0.80 | 13.45 |
| 1872 | 0.80–1.20 | 18.70–16.20 | 1892 | 0.90 | 13.88 |
| 1873 | 0.80 | 16.00–12.00 | 1893 | 0.90 | 13.88 |
| 1874 | 0.80 | 13.00–12.50 | 1894 | 0.90 | 13.88 |
| 1875 | 0.80 | 12.50 | 1895 | 0.90 | 13.88 |
| 1876 | 0.80 | 12.00 | 1896 | 0.90 | 14.25 |
| 1877 | 0.80 | 11.00 | 1897 | 0.90 | 14.25 |
| 1878 | 0.80 | 9.20 | 1889–1908 | 0.90 | 14.70 |
| 1879 | 0.80 | 11.00 | | | |
| 1880 | 1.00 | 11.15 | | | |

The figures given in Stange (p. 95), Engelke (p. 38), and Schulze (p. 59) vary slightly from those given above.

The syndicate has had no effect in decreasing the expenses of production; its influence has actually been exerted in the opposite direction. The economies which have been effected by syndicate organization have been in distribution, — elimination of the wastes of competitive selling and increase in the effectiveness of advertising. But, tho these savings have been considerable, the syndicate and the legislation enacted in the attempt to check tendencies induced by syndicate policies have contributed to bring into existence such an over-supply of facilities for production that no net gain in efficiency has resulted. Since the demand for potash is only sufficient to give existing establishments employment much below normal capacity, there is good reason to believe that expenses of production are higher than they would be under competitive conditions, and that costs as well as prices would be lower.

Domestic consumers, as noted above, have fared somewhat better than the foreign. The influence of the government mines has always been exerted in the direction of lower prices for domestic consumers. Most favored have been the large agricultural associations, — in part, it is alleged, because of their political influence. The favoritism shown to these societies has led to many complaints from potash dealers. The syndicate finally made some concessions to the dealers in 1905, but did not place them in every particular on a footing with the agrarian associations.[1] After 1909, when the restrictions on combination among dealers were removed, a large number of dealers' organizations sprang up to take advantage of the rebates given for purchase in large quantities. But the agricultural associations

[1] Helmann, pp. 15, 35.

are still favored. The attitude of dealers has generally been unfriendly to the syndicate.

One must not neglect to give the potash combination credit for what it has accomplished in connection with its propaganda work. By the distribution of publications, exhibits at important agricultural shows, fertilizer experiment stations, and other methods, it has conducted a general educational campaign on the use of fertilizer, potash especially. The efforts of the syndicate to keep up the standard of the products and to insure prompt deliveries are also commendable.

The membership of the Prussian government has given the potash syndicate a character distinct from other Kartells. Far from being a passive member, the government has always exerted a large influence upon syndicate policy. More than once it has directed its energy toward keeping the organization intact in the numerous crises through which it has passed. In the negotiations of 1879, 1888, 1898, and 1901, the fisc took an active pro-syndicate part; when renewal came up in 1903, the Prussian fisc took the initiative; in 1908, the government early directed its influence toward renewal. It cannot be seriously doubted that, had not the Prussian government played the part it did, the syndicate would early have gone to pieces.

The opinion so often expressed during the progress of syndicate negotiations that in the continuance of the syndicate lay the only means to avoid the ruin of a number of enterprises and losses to thousands of investors, was undoubtedly correct.[1] But one may doubt whether or not it was wise to enter into combination to preserve the profitableness of all the undertakings, when the policy of procrastination, as one might term it, caused and will continue to cause much greater

[1] It is said that bankers would extend credit only to those mines whose intention to enter the syndicate was known. K. R., vol. v, p. 307.

losses. Free competition during the eighties would have been attended with losses smaller than in the decade 1900 to 1910, or none at all. The dependence of the value of potash enterprises upon the existence of the syndicate is clearly shown in the course of the market for potash securities during the past decade. It is reasonable to suppose that under the rule of competition the enormous over-investment of capital in potash enterprises would largely have been avoided. When all is said for and against the syndicate, one may doubt whether the potash industry is, as a whole, in 1913, in a more flourishing financial condition as a result of the existence of combination.

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# INDUSTRIAL BOUNTIES AND REWARDS BY AMERICAN STATES [1]


## SUMMARY

Direct grant one of many forms of state aid, 192. — Bounties on mulberry trees and silk, 193. — Hemp, flax, jute, and ramie, 197. — Woolen yarn, 199. — Binding twine, 199. — Starch, 199. — Iron and iron pipe, 199. — Cordage, 199. — Cards, 199. — Wheat and corn, 200. — Salt, 200. — Artesian wells, 201. — Timber and shade trees, 201. — Sugar, 202. — Chicory, 202. — Rewards on arms and powder, 203. — Sheep and woolen cloth, 203. — Canaigre and leather, 203. — Wheat, oats, and potatoes, 204. — Salt, 204. — Coal mine and artesian and oil wells, 204. — Methods of treatment of ores, 205. — Timber and shade trees, 205. — Sugar, 205. — The California reward act of 1862, 205. — The question of public policy and constitutionality, 206.


THE claims of our national ward, Infant Industry, have been constantly presented before Congress and also before our state legislative bodies, but with results which have received too little comprehensive attention from the student of public affairs. True, there is no end to the discussion of the protective tariff, tho the economist has long since satisfied himself as to the theoretical aspects of the subject. Our two experiments with national bounties — fisheries in 1813 and sugar in 1890 — are recognized as noteworthy instances of departure from what has come to be the established method of protection. Little is known, however,

[1] This study was undertaken with a two-fold purpose: first, of course, to present a true statement of the subject chosen; second, to show something of the wealth of materials of economic history scattered throughout the dusty files of the session laws. As over a hundred acts are considered, it has seemed impracticable to give specific citations except in case of acts still in force. Furthermore, it is unnecessary, since any person who knows the year can easily find any desired act.

of the measures adopted by the state governments to establish and promote home industries through favorable legislation; yet the files of the session laws contain abundant and unimpeachable evidence that from earliest colonial times our local legislative assemblies have actively concerned themselves with such matters, thus maintaining a direct relationship between American state subventions and the British and Continental bounty systems of two and three centuries ago.

This is not the time or the place for a general treatment of state encouragement of industrial enterprises. There must be much searching among scattered source materials before an adequate basis of fact can be established; and the results, when obtained through the efforts of many, could hardly be presented within the limits of a single article. For the scope of state activity in this direction has been limited only to the extent that the imagination of legislators and of lobbyists has been limited. It includes such measures as patents of monopoly; grants in aid of individuals engaging to construct certain machinery, to perfect certain manufacturing processes, or to produce certain goods; grants of land or of lottery privileges for the construction of mills; exemption from militia service of operatives in mills; exemption from taxation, tax drawbacks, and limited rates of assessment upon industrial property; bounties and rewards, or grants of money, in aid of certain branches of industry; and also enabling acts authorizing local governmental bodies to extend similar favors. This paper will be limited to a summary consideration of state industrial bounties and rewards, tho incidental reference will be made to some of the colonial precedents.

From earliest colonial times until late in the last century, attempts were made to introduce silk culture

in America. Virginia in 1623 required the planting of mulberry trees, and offered a bounty on reeled silk. South Carolina, Pennsylvania, New Jersey, and possibly other provinces took similar action, but with little success. White mulberry trees [1] were introduced in Mansfield, Connecticut in 1760, and without the stimulus of a bounty this town soon became an active center of silk culture. In 1783, Connecticut came to the aid of the industry with an act which offered a bounty of ten shillings for every hundred mulberry trees and three pence for each ounce of raw silk. This was repealed in 1784, by an act which provided for a bounty of two pence per ounce of silk, to be paid out of the duties arising from the importation of foreign goods into the state, as established by another act passed at that session. The only state which seems to have been influenced by the action of Connecticut was New York, which in 1791 offered a bounty of six shillings for every fifty mulberry trees up to two hundred.

The Connecticut bounty had little effect except in the vicinity of Mansfield, where considerable sewing silk was produced. It expired in 1794, but the silk industry continued to prosper, as is evident from the reports of the national census of 1810.[2] In 1825, Congress became interested; and the following year the House of Representatives directed Richard Rush, Secretary of the Treasury, to prepare a manual on the growth and manufacture of silk. The result was a comprehensive report of over two hundred pages,

[1] The leaves of the native red mulberry are not suitable for silk worm feeding.

[2] Connecticut produced sewing silk and raw silk valued at $28,503; of which Windham county produced $27,375; Tolland county, $774; and New London county, $384. In Hampshire county, Massachusetts, 103 pounds, valued at $618, were produced. Burlington county, New Jersey, reported 1800 "yards made" by a single tax establishment, the value being $1800, but the nature of the product is not indicated. — Tench Coxe, American Manufactures, pp. 5, 28, 39.

which was published in 1828.[1] This report, commonly known as the "Rush letter," aroused interest throughout the country. A convention was held at Mansfield to seek aid of Congress,[2] but without success. The natural result was a general appeal to the state legislatures.

Connecticut responded in 1832, with an act which offered bounties of fifty cents a pound on reeled silk and one dollar for every hundred mulberry trees. This act was repealed in 1839. Massachusetts in 1835 offered a bounty of fifty cents a pound on cocoons, but reduced this to ten cents the following year, adding bounties of fifty cents a pound on reeled silk and one dollar a pound on reeled and thrown silk. Other bounty acts were passed in 1839 and 1845, the latter being effective for three years only. Vermont, also in 1835, offered a bounty of ten cents a pound on cocoons, and in 1838 bounties of twenty cents a pound on reeled silk and sewing silk. In 1840, the legislature by special act directed the state treasurer to pay to Sally Fisher of Calais twenty cents for each pound of woven silk which she should make from native cocoons. By another act, approved only a day later, it offered a general bounty of twenty cents a pound on woven silk, and withdrew the bounty on sewing silk. In 1844 it offered bounties of fifteeen cents a pound on cocoons, reeled silk, and sewing silk. The system was abolished in 1845. Maine passed a silk bounty act in 1836, which was repealed as obsolete in 1903. Delaware, which in 1829 had offered medals

[1] 20 Cong., 1 Sess., H. doc. 158.

[2] "We find from experience and observation, that mankind are more easily induced to engage in those branches of business which afford an immediate profit; and require something to stimulate to engage in a business which must be matured by the revolutions of seasons. It is this stimulant, which it is the peculiar duty of the Government to afford." — Memorial of sundry inhabitants of the counties of Windham and Tolland. 20 Cong., 1 Sess., H. doc. 159.

for the growth of mulberry trees, offered silk bounties in 1837, 1839, and 1843, the last of which expired in 1845. New Jersey and Georgia passed such acts in 1838, but repealed them after a year. The Pennsylvania act of 1838 expired in 1843. Illinois and Ohio in 1839 adopted bounty laws which respectively expired in 1842 and 1844. New York joined the silk bounty states in 1841 for a period of five years.

These laws were not obtained without vigorous efforts on the part of promoters, one of whom went so far as to propose silk culture as "a substitute for railroads, canals, and navigable rivers." Theoretically the argument was unassailable. "Those sections of the country that are too far from navigable rivers to have the advantage of cheap transportation for their present productions have no other remedy than the construction of railroads or canals, and if they are unable to construct either of these, they are absolutely without a market. For a state of things like these there is but one remedy," which of course was the culture of silk, "which will bear the present charges and yet leave the producer a profit."[1]

The decade of the thirties is remembered as a period of excessive speculation in lands and in railroads, and it was only natural that the wide-spread movement for the introduction of silk culture should have attracted those who cared for nothing except immediate profits. The opportunity was found in the mulberry trees, the supply of which was limited. These trees changed hands at rapidly rising prices, and the ultimate returns from the production of silk were put forward as a lure by those whose aim was direct profit through exploitation of a temporary market. The bubble burst in 1839, and within a few years a blight destroyed many

[1] Journal of the American Silk Society, II, p. 53.

of the trees.[1] That this mania was not without its effect upon the minds of contemporary legislators is indicated by the number of repealing acts which have been mentioned. Yet the sewing silk industry made some permanent advance at this time, and factories were established at Paterson, at South Manchester, Connecticut, and at Northampton.

After an interval of many years, California, unmindful of the experience of eastern states, became ambitious to be known as a center of silk production. It was urged that the freedom from electric storms was a condition favorable to the worms, and that no artificial heat would be required for hatching the eggs. Accordingly a bounty act was passed in 1866, but was soon found to have been so loosely drawn as to afford little protection to the treasury. It was supplanted in 1868 by an act of like intent, by which the state offered to each person a single bounty of two hundred and fifty dollars for growing five thousand or more mulberry trees and also offered a general bounty of three hundred dollars for the production of each hundred thousand cocoons. An attempt was made without delay to plunder the state treasury by drawing imaginary lines through each tract of land set with the trees so as to include in each subdivision the minimum five thousand and establish the basis of a claim for plural bounties. Such claims were allowed by the board of judges chosen to administer the law, but were set aside by the supreme court.[2] The act was repealed in 1870 without having accomplished its purpose.

[1] Wyckoff, Report on the Silk Manufacturing Industry, Tenth Census, II, pp 920–921; Brockett, Silk Industry in America, pp. 38–40; Cowdin, Report to the Department of State on Silk, p. 12.

[2] Attorney General v. Board of Judges, 38 Cal. 291; Message of Governor H. H. Haight, 1869, pp. 20–21.

Kansas, by an act passed in 1887, provided for a board of silk commissioners to establish and conduct a state silk station and to encourage state wide production of silk by various means, among which was the payment of bounties. No appropriations for bounties were made at subsequent sessions of the legislature, and it does not appear that any were paid. The undertaking was abandoned in 1897, and the sale of the station was ordered the following year. Utah in 1896 passed an act which authorized the appointment of a silk commission, and offered a bounty of twenty-five cents a pound on cocoons for a period of ten years. Under this act several thousand pounds of cocoons were presented for bounty each year until 1905, when the commission was abolished and the bounty offer withdrawn.[1]

While silk was the favorite subject for encouragement by means of bounties, other textile materials were also aided in this manner. Parliament offered bounties to promote the production of hemp and flax in the American colonies; and the majority of the colonial assemblies established bounties on one or both. Linen bounties were also common; and New Hampshire and Massachusetts gave bounties on cards. These attempts resulted in almost complete failure.

New York offered the first state bounty on hemp by an act of 1788, which provided that eight shillings should be allowed on each hundred weight. The act was in force until 1795. Connecticut, by an act passed in 1804 and repealed in 1813, gave hemp bounties at the rate of ten dollars a ton. New Hampshire in 1811, offered a bounty of five dollars for five hundred pounds of hemp produced by any inhabitant of the

[1] Utah Silk Commission, Reports, 1899–1904.

state in any one year, and one dollar for each hundred weight in excess of the minimum. This appears to have been in force until 1824.

New Jersey in 1880 passed an act to encourage the production and treatment of fibres, which offered bounties at the rate of five dollars a ton for jute and rose or marshmallow, six dollars a ton for hemp, seven dollars a ton for flax, and ten dollars a ton for ramie or China grass. In order to encourage the perfection of machines for removing the fibre from the stalks, bounties were also offered for disintegrated jute at the rate of two and a half cents a pound; for cleaned hemp, three cents; for cleaned flax, three and a half cents; and for disintegrated ramie, five cents. As a special inducement to ramie culture a bounty of ten cents a pound was offered on ramie yarn ready to weave. These bounties were limited in aggregate to fifteen thousand dollars, which was appropriated in equal parts for stalks, fibre, and ramie yarn. The disappointing results of the law were reported by the secretary of the state bureau of labor and industry, who had been active in getting it enacted. The whole of the appropriations for stalks and for fibre was granted on flax straw and cleaned flax. "Notwithstanding the liberal bounties offered for the cultivation of jute, ramie, and hemp, we cannot learn that any persistent effort has been made to raise these plants in New Jersey, and it is not at all probable that the $5000 remaining unpaid out of the appropriation of $15,000 will be called for before the time specified in the law at which paying of bounties shall cease, viz., the first day of April, 1885."[1]

California in 1891 attempted to introduce ramie culture by an act which provided among other things

[1] Annual Report, 1883–84, p. 319.

that the state board of agriculture might give bounties of not over a cent a pound on the fibre, but the act was declared unconstitutional on technical grounds in 1892. North Dakota in 1895 offered a bounty of one dollar for each hundred pounds of long line spinning fibres, either flax or hemp, and spinning tows. This expired in 1900; and the reports of the state auditor fail to show that any payments were made.

In a few states bounties on manufactures have been offered. Connecticut in 1788 promised a bounty of a penny a pound on woolen yarn spun within the next year. North Dakota established a bounty of two dollars a ton on binding twine in 1890, and in 1895 one of a dollar a ton for five years; but it does not appear that bounties were paid under either act. This state, also in 1890 and 1895, offered a bounty of a cent a pound on potato starch for terms of five years, and payments were made under both acts. A Utah act of 1890 provided for bounties, limited to thirty thousand dollars during a period of two years, on manufactured iron at two dollars a ton, cast iron or wrought iron pipe at five dollars a ton, rope or twine at a cent a pound, and sugar from sorghum or other sugar bearing plants at a cent a pound. But under this act a claimant for bounty on manufactured iron must have erected a plant at a cost of one hundred thousand dollars, with a capacity of twenty tons a day; and similar qualifications were required of claimants of the other bounties. There were other requirements which served to protect the interest of the state more adequately than was done in most laws of the kind. Alabama in 1861 offered bounties on cotton and wool cards for a period of two years.

Bounties on grain were common in colonial times, but they have been granted by only two states. Maine

in 1837 established a bounty on wheat; in 1838, it added a bounty on Indian corn. The rates varied according to the amounts produced, ranging from three to ten cents a bushel on wheat and from ten cents a bushel to two dollars for thirty bushels on husked ears of corn. These acts were repealed in 1839. Massachusetts, by an act passed in 1838, offered a bounty of two dollars for fifteen bushels of wheat, and five cents for each additional bushel. This act expired in 1841. Large sums were paid out by both states under these laws.

Salt bounties have been granted in three states, but for different purposes. After several years of experimentation with native brine, Michigan in 1859 passed an act to encourage the manufacture of salt, offering a bounty of ten cents a bushel. This gave place to another act, in 1861 providing for a bounty of the same amount on each barrel of five bushels, which was repealed in 1869. New York in 1822 passed an act with the declared purpose of encouraging the manufacture of coarse salt in the western district of the state. This offered a bounty of three cents a bushel on salt delivered at the Hudson or at Lake Erie, or shipped from Oswego into Upper Canada during a five-year period beginning in 1827. It seems probable that this was really intended to stimulate traffic on the state canals and so increase the returns from tolls. This supposition is strengthened by the fact that in 1843, another bounty act was passed "to increase the revenues of the state." By this act a complicated schedule of bounties was established, not only on salt but also on coal, lead, and gypsum, the rates varying with distances as well as weights. There was also a bounty on empty barrels passing over the canals, which was in effect a drawback of the amount by which

the tolls exceeded the rates on an equal quantity of staves and heading. It was repealed in 1846. Alabama in 1861 authorized the leasing of all salt wells belonging to the state and the payment to the lessee of a bounty of ten cents for each bushel sold to citizens of the state, but the provision for a bounty was repealed a year later. The obvious purpose of this act was to insure against a salt famine on account of the cutting off of existing sources of supply by the public enemy.

Bounties to encourage prospecting for a belt of artesian water were established by Nevada in 1879 and in 1887, by acts which in amended form are still in force.[1]

Minnesota was the pioneer in the granting of bounties for the planting of timber and of shade trees along highways, having passed laws in 1873 and 1881, which after frequent amendments are in force today. The law as it now stands offers to any person who shall plant one acre of prairie land with forest trees and keep them in a thrifty condition, two dollars and fifty cents an acre for six years, provided such bounty shall not exceed twenty-five dollars to any individual in any one year. For the purpose of paying such compensation, there is a standing appropriation of $20,000 each year.[2] Similar acts were passed by Colorado in 1881, Dakota in 1885, and by North Dakota and South Dakota in 1890. The Colorado law was declared unconstitutional on technical grounds in 1892. Connecticut in 1881 offered a bounty for planting trees along highways. The terms were made more liberal by an amendment in 1885, but up to 1909, only about a thousand dollars had been paid out in bounties at the rate of a few dollars to a few persons each year. The rate was formerly ten cents a tree;

[1] Rev. L. 1912, §§ 702–711.

[2] L. 1913, c. 76, amending Rev. L. 1905, §§ 2391–2395.

under the present law it is twenty-five cents.[1] As to the need for such a law in a well-wooded state like Connecticut, comment would seem to be superfluous.

As early as 1837, Massachusetts offered a bounty on beet sugar at the rate of three cents a pound for five years, and a factory was established at Northampton but soon abandoned. Again this state in 1883 established a bounty of one dollar a ton on sugar beets or sorghum cane for three years, and a factory was established at Franklin. In 1887, Maine passed an act authorizing the governor and council to contract with any responsible party or company to pay a bounty not to exceed a cent a pound on all beet sugar manufactured in the state from native beets through a period of ten years. As a result of this act a factory was established at Portland. Michigan and New Jersey passed sugar bounty laws in 1881. Michigan offered two dollars on each hundred pounds of sugar for five years. New Jersey for a like period offered a cent a pound on sugar, to be paid to the manufacturers; and a dollar a ton on sugar beets or cane, to be paid to the growers. Under this act a factory was established at Cape May. Kansas in 1887 offered a bounty of two cents a pound on sugar for five years; and Nebraska, by an act passed in 1889 and repealed in 1891, offered a sugar bounty of one cent a pound. This completes the record to 1890. To carry the discussion further would be to trespass upon ground which has already been covered by a note in this Journal.[2] It should be mentioned, however, that the Nebraska beet sugar act of 1895 also offered bounties on chicory.

[1] Pub. Acts, 1909, c. 86.

[2] Cherington, "State Bounties and the Beet Sugar Industry," vol. xxvi, pp. 381–386.

The terms "bounty" and "reward" are closely allied in meaning, but strictly speaking the use of the former is appropriate only in cases where the action of many is desired, and each may obtain the promised compensation without reference to the claims of others; while the latter is properly used only in cases where a premium is offered for a service which can be performed only once by one or at most a few, who succeed while others fail. Needless to say, no such distinction is found in the statutes, and a study of one cannot be made without reference to the other.

With the double purpose of providing for the public safety and of encouraging manufactures, North Carolina in 1794 offered rewards for the best musket and bayonet, horseman's pistols, and horseman's sword made in each brigade (militia district) in the state; also for the greatest quantity of powder made in each superior court district. These rewards were to be given each year for three years.

New York passed two acts in 1808 with the purpose of encouraging the woolen industry. One offered a reward for the introduction of the first thorobred Merino ram in each county of the state where there was none, within three years. The other offered a series of annual rewards for three years for the best specimens of woolen cloth, and an additional reward for such cloth made in the home. Utah in 1854 offered premiums for the greatest yield of flax seed and lint and of hemp lint. A similar act in 1855 also provided for rewards for "tame" sunflower seeds. In 1857, an attempt was made to encourage the raising of cotton, indigo, and madder.

In 1896, Utah came to the aid of the leather industry by an act which offered a bonus of a dollar a ton on the first twenty thousand tons of canaigre produced and

used in the manufacture of leather, and another reward of a thousand dollars to the person or corporation who would first make fifty thousand pounds of leather tanned with canaigre roots.

Massachusetts in 1838 offered, in addition to a bounty on wheat, a reward of one hundred dollars to the person in each county who would raise the greatest quantity of wheat in any one year on one farm. Wyoming in 1890 offered rewards, in addition to those which had been offered by an agricultural journal, for the greatest yield of potatoes, oats, and wheat, each upon a single acre.

Vermont, by an act passed in 1827, authorized the state treasurer to pay to the Vermont Salt Manufacturing Company, the sum of five hundred dollars as a premium on the first five hundred bushels of salt manufactured from water obtained by boring in Montpelier.

In the far west, the reward has been employed as an incentive to prospectors. Utah offered a reward of a thousand dollars in 1854 for the opening of a good coal mine within forty miles of Salt Lake City. The reward was claimed in 1860, but was refused on account of excessive distance and inferior quality of the coal.[1] Colorado in 1870 adopted a law to promote agriculture by irrigation, which offered a reward of two thousand dollars to the person who, under carefully prescribed conditions, would sink an artesian well to a depth of a thousand feet or such less distance as might be necessary. Arizona in 1873 offered the sum of fifteen hundred dollars as a reward to the person who should first obtain a stream of flowing artesian water not less than ten miles from a living stream. In 1901, Nevada passed an act to encourage the boring of wells in searching for oil, natural gas, and artesian water. This

[1] Legislative Journal, 1860–61, p. 73; 1862–63, pp. 65–66.

act, which is still in force, offers a reward of one thousand dollars to the person who first furnishes five barrels of crude petroleum, and a like sum to the discoverer of natural gas to the extent of one thousand cubic feet; also twenty-five hundred dollars to the person first to sink a six-inch well to a depth of one thousand feet and obtain a flow of sixty gallons of water a minute. It is also provided in this remarkable piece of legislation, that any person who receives any of the rewards must enter into a contract to reimburse the state if he succeeds in developing his enterprise to a marketable stage.[1] In 1887 the same state passed an act to encourage the mining and milling of ores containing precious metals, by which it was provided that a series of rewards should be given for the most economical and also for the most successful method of treatment and reduction of ores.

Minnesota from 1867 to 1889 provided for annual rewards to be given through the state board of agriculture for the best five-acre tract of cultivated timber or continuous half mile of hedge.

Rewards to encourage the sugar industry have been offered by Delaware and Utah. Delaware in 1877 appropriated three hundred dollars to be used in 1877 and 1878 for premiums for beets containing the greatest quantity of sugar, and two years later appropriated fifteen hundred dollars for the years 1879 and 1880. Utah in 1880 offered two thousand dollars as a reward to the person who would produce the best seven thousand pounds of sugar within that year, and in 1882 offered five thousand dollars to be paid under the same conditions in either 1882 or 1883.

The California reward act of 1862 has been reserved for separate notice, not only because it was unique

[1] Rev. L. 1912, §§ 712–717.

but also because it shows how far a state may go in the attempt to foster home industry. This act offered one hundred and thirty-nine premiums, aggregating $129,850, on fifty-three agricultural and manufactured products, comprising textile fibres, cloth, carpets, clothing, boots and shoes, paper, naval stores, cordage, indigo, rice, sugar, vegetable oils, tea, coffee, hops, wine bottles, and exported beer. It was amended in 1863, and finally repealed in 1870, after less than half the amount offered had been paid.[1]

In the foregoing pages but three southern states have been mentioned — Alabama, North Carolina, and Georgia — and the first two only in connection with acts passed for military reasons. Yet the southern colonies, particularly South Carolina, had been most active in the giving of bounties. The main reason for this change of attitude was undoubtedly the general acceptance of the Jeffersonian idea that the state should interfere as little as possible in matters primarily affecting the individual, and that the words "public purpose" should be most strictly construed. Had this idea prevailed throughout the rest of the country, the states would have been spared an unnecessary drain upon their treasuries, and private individuals would not have been encouraged to waste their capital in enterprises unsuited to their surroundings. Fortunately, however, the courts have not been able to approve a system which results in a general tax for the good of a single class. In an opinion as to gifts of money by towns in aid of manufacturing enterprises the supreme court of Maine declared: —

> Capital naturally gravitates to the best investment. If a particular place or a special kind of manufacture promises large returns,

[1] California State Agricultural Society, Transactions, 1863; Messages of Governor Leland Stanford, 1863; Inaugural address of Governor H. H. Haight, 1867, and Message, 1869.

the capitalist will be little likely to hesitate in selecting the place and in determining upon the manufacture. But whatever is done . . . it is done with the same hope and expectation with which the farmer plows his fields and sows his grain, — the anticipated return.

Now the individual or corporate manufacturing will in the outset promise to be, and the result will be, either a judicious and gainful undertaking, or an injurious and losing one. If the manufacturing be gainful, there seems to be no public purpose to be accomplished by assessing a tax on reluctant citizens, and coercing its collection to swell the profits of successful enterprise. If the business be a losing one, it is not readily perceived what public or governmental purpose is attained by taxing those who have received no share of the profits, to pay for the loss. . . . The tax payer should not be compelled to pay for the loss when he is denied a share of the profit.[1]

In every case in which bounty acts have been attacked upon grounds of public policy, the courts have declared them unconstitutional. Thus the Michigan supreme court declared of the sugar bounty of 1897:

It is void whether it comes within any of the express provisions of the constitution or not. It is not a law, but an act which attempts to take the property of one citizen, and turn it over to another; to compel one class to donate a part of its property to another.[2]

This ruling was followed by the supreme court of Minnesota in a case concerning the sugar bounty act of 1895,[3] and by the Nebraska supreme court in a case concerning the sugar and chicory bounty act of 1895,[4] and also in a federal case relating to a local bounty.[5] The Michigan case, therefore, assumes increased importance; but when we come to examine

[1] Opinion of the Judges, 58 Me. 590 (1871), citing Sharpless v. Philadelphia, 21 Pa. 147 (1853).

[2] Michigan Sugar Co. v. Auditor General, 124 Mich. 674, 678 (1900).

[3] Minnesota Sugar Co. v. Iverson, 91 Minn. 30 (1903).

[4] Oxnard Beet Sugar Co. v. State, 73 Neb. 66 (1905).

[5] Dodge v. Mission Township, 107 Fed. 827 (1901). An earlier local bounty case is Deal v. Mississippi County, 107 Mo. 464 (1891).

it, we find that it is based upon the decision by Justice Cooley in a railroad subsidy case, which aroused quite as great a storm of protest in its time as the state bounty decisions. It is fitting, therefore, that this paper should close with the words of that great jurist, who said:

> The state can have no favorites. Its business is to protect the industry of all, and to give all the benefit of equal laws. It cannot compel an unwilling minority to submit to taxation in order that it may keep upon its own feet any business which cannot stand alone. Moreover, it is not a weak interest only that can give plausible reasons for public aid. When the State once enters upon the business of subsidies, we shall not fail to discover that the strong and powerful interests are the most likely to control legislation, and that the weaker will be taxed to enhance the profits of the stronger.[1]

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[1] People v. Township Board of Salem, 20 Mich. 452, 466 (1870).

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